APPENDIX A

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 98-1227—98-1232, 98-1297 & 98-1298

ANADARKO PETROLEUM CORPORATION, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

AMOCO PRODUCTION COMPANY, *et al.*
Intervenors.

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Argued Sept. 7, 1999

Decided Oct. 29, 1999

Rehearing Denied Dec. 21, 1999

Before: EDWARDS, Chief Judge, SENTELLE and RANDOLPH, Circuit Judges.

Opinion for the Court filed by Circuit Judge RANDOLPH.

RANDOLPH, Circuit Judge:

Petitioners in these consolidated cases are natural gas producers, and the State of Kansas and the Kansas Corporation Commission. Four issues are presented. The first concerns our jurisdiction. The remaining three deal with the Federal Energy Regulatory Commission's resolution of proceedings initiated in the wake of *Public Service Co. of Colorado v. FERC*, 91 F.3d 1478 (D.C.Cir.1996).

Although we will presuppose knowledge of our opinion in *Public Service* and its predecessor, *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769 (D.C.Cir.1988), a description of the issues before us requires some restatement of the litigation that brought this matter to its present posture.

I. PRIOR PROCEEDINGS

Title I of the Natural Gas Production Act (NGPA), enacted in 1978, imposed maximum lawful prices on first sales of certain categories of natural gas, but § 110 of the NGPA allowed producers to recover from their customers charges in excess of the maximum limits "to the extent necessary to recover . . . State severance taxes attributable to the production of such natural gas and borne by the seller." 15 U.S.C. § 3320(a)(1) (1988) (repealed); *see also id.* §§ 3311-3333 (1988) (repealed). After passage of the NGPA, the Commission continued to adhere to an earlier agency opinion [1] treating the Kansas *ad valorem* tax imposed on producers as such a severance tax. *See, e.g., Independent Oil & Gas Ass'n of W.Va.*, 7 F.E.R.C. ¶ 61,094 (1979); *Trio Petroleum Corp.*, 18 F.E.R.C ¶ 61,203 (1982). In a petition filed on October 4, 1983, several customers of Kansas producers tried unsuccessfully to persuade the Commission

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[1] *See* Opinion No. 699-D, *Just and Reasonable Rates for Sales of Natural Gas*, 52 F.P.C. 915 (1974).

to change its mind. *See* Notice of Petition to Reopen, Reconsider and Rescind Opinion No. 699-D, 48 Fed.Reg. 45,287 (1983); *Sun Exploration & Prod. Co.*, 36 F.E.R.C. ¶ 61,093 (1986), *reh'g denied sub nom. Northern Natural Gas Co.*, 38 F.E.R.C ¶ 61,062 (1987).

On judicial review, we held in *Colorado Interstate* that the Commission's decision in *Sun Exploration* "fell short of reasoned decision-making." 850 F.2d at 770. We remanded the matter to the Commission so that it might, if it could, offer some "cogent theory of what makes a tax 'similar' to a production or severance tax under § 110" of the NGPA. *Id.* at 773. Five years passed before the Commission acted on remand. In a ruling handed down after Congress had repealed § 110 of the NGPA,[2] the Commission determined that the Kansas *ad valorem* tax was not the equivalent of a severance tax attributable to production and therefore producers already charging the maximum price could not recover the tax from their customers. *See Colorado Interstate Gas Co.*, 65 F.E.R.C. ¶ 61,292 (1993), *reh'g denied*, 67 F.E.R.C. ¶ 61,209 (1994). The Commission ordered the producers to repay all overcharges made after June 28, 1988, when our *Colorado Interstate* opinion issued. Our opinion, the Commission believed, gave the producers sufficient notice to alter their sales practices. *See* 65 F.E.R.C. at 62,372-73, 67 F.E.R.C. at 61,660.

When we reviewed the Commission's action in *Public Service*, we agreed with the Commission's reconsidered position on the Kansas tax. But we disagreed with the Commission about the extent of the producers' refund obligation. In our opinion, "the producers' liability for re-

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[2] On January 1, 1993, the Natural Gas Well-head Decontrol Act of 1989, Pub.L. No. 101-60, 103 Stat. 157, came into effect, eliminating the price limitations Title I of the NGPA had imposed.

funds extends back to October [4,] 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 110 of the NGPA was at issue." 91 F.3d at 1490. Although "anything short of full retroactivity (*i.e.*, to 1978) allow[ed] the producers to keep some unlawful overcharges without any justification at all," we limited the producers' liability to October 1983 because that was "the earliest date advocated by any party before the court." *Id.*

After our *Public Service* decision issued, the producers invoked the Commission's procedures for making equitable adjustments to refund payments "as may be necessary to prevent special hardship, inequity, or an unfair distribution of the burdens." 15 U.S.C. § 3412(c). Collectively, the producers advanced two claims not explicitly decided in *Public Service*: they requested a waiver of the interest due on the overcharges they had to repay for the period between October 1983 and June 1988; and they requested a reduction in their repayment obligation to the extent Kansas had overvalued (and thus overtaxed) the gas they had sold under the belief that those taxes were recoverable. In two orders, the second on rehearing, the Commission rejected these petitions for a blanket waiver but said it would allow individual producers to obtain relief upon a sufficient showing of hardship. *See Public Service Co. of Colo.*, 80 F.E.R.C. ¶ 61,264, at 61,952 (1997) (*Public Service Order I*), *reh'g denied*, 82 F.E.R.C. ¶ 61,058, at 61,213, 61,214 (1998) (*Public Service Order II*). The producers also challenged the Commission's interpretation of the *Public Service* decision's starting date for their repayment obligation. As the Commission read our opinion, the producers were liable to pay refunds of revenues collected in excess of the applicable maximum price based upon any tax bill rendered after October 4, 1983. As against this, the producers argued that the Commission should have prorated the annual tax bill they re-

ceived from Kansas in 1984, an error which they believed added nine months to the repayment obligation imposed by this court. *See* Reply Brief of Petitioners (Producers) at 19.

II. JURISDICTION

With respect to the portions of the orders denying the producers' request for a generic, or collective, waiver of interest on amounts to be refunded, the Commission tells us the producers are not "aggrieved" within the meaning of 15 U.S.C. § 3416(a)(4). The idea is that they may still seek, and the Commission may still grant, individual equitable adjustments based on a producer's unique circumstances. We do not think this possibility eliminates the injury the producers, as a whole, suffered as a consequence of the Commission's rulings. The rulings have "necessary legal significance." *Marathon Oil Co. v. FERC*, 68 F.3d 1376, 1379 (D.C.Cir.1995). For one thing, no producer would need to request individual relief if the Commission had granted a generic waiver of interest. For another the Commission set procedures in place for the customers to receive refunds back to October 1983, including interest. *See Public Service Order I*, 80 F.E.R.C. at 61,956-57. If the Commission can deny the producers' claim for a waiver of interest *en masse* and order repayment—as it has done—then the producers may petition for judicial review from the Commission's judgment. Otherwise, one might as well say that a class representative has no standing to challenge a district court's order refusing to certify a class because the potential members of the class may still bring individual claims for relief. That, of course, is not the law. *See, e.g., Deposit Guaranty Nat'l Bank v. Roper*, 445 US. 326, 100 S.Ct. 1166, 63 L.Ed.2d 427 (1980).

Marathon Oil Co. is not to the contrary. The details of the case defy brief description. Suffice it to say that

the court held only this: injury-in-fact could not be established on the basis of speculation about whether the Commission's refusal to act would affect later determinations by the Internal Revenue Service to grant or deny tax credits. *See* 68 F.3d at 1379. Nothing comparable is present here. There is no guesswork involved in assessing the impact of the Commission's decision.[3] If the decision stands, a producer could be relieved from having to pay interest only by establishing conditions specific to itself. *See Public Service Order I*, 80 F.E.R.C. at 61,952; *Public Service Order II*, 82 F.E.R.C. at 61,213, 61,214

III. INTEREST

The Commission's general policy, in effect for many years, requires interest to be paid on various kinds of overcharges. *See* Natural Gas Policy and Procedures, FERC Statutes and Regulations, Regulations Preambles 1977-1981, ¶ 30,083 (1979), *reprinted in* 44 Fed.Reg. 53,493 (1979), *aff'd United Gas Pipe Line Co. v. FERC*, 657 F.2d 790, 794-96 (5th Cir. 1981). This policy serves three purposes: to "(1) provide just compensation for the losses, or costs, imposed upon those who have paid excessive rates; (2) reflect the benefits which were available to companies which collected excessive rates; and (3) not provide incentives for any party to prolong litigation."

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[3] In addition to *Marathon*, the Commission cites *Southwest Gas Corp. v. FERC*, 40 F.3d 464, 468 (D.C. Cir.1994), and *Tenneco, Inc. v. FERC*, 688 F.2d 1018, 1022 (5th Cir.1982), neither of which make its point. *Southwest Gas* is a run-of-the-mill decision holding that the petitioner failed to establish any nonspeculative injury resulting from agency action. *Tenneco* merely holds that the petitioner was not aggrieved by the agency's dismissal of an adjudicatory proceeding in order to allow the agency's newly formed investigative division to gather more evidence before going forward. *See* 688 F.2d at 1021. The dismissal adjudicated nothing; it did not fix petitioner's rights; and it did not command petitioner to do or to refrain from doing anything. *See id.*

See id. at 30,546; 44 Fed.Reg. at 53,494. To these ends, the regulation governing price increases for the recovery of severance taxes gave notice that any such increases were "subject to a general obligation to refund any portion of the price, together with interest." 18 C.F.R. § 270.101(2)(e) (1993); *see also* 18 C.F.R. § 154.102(c).

"Compensation deferred is compensation reduced by the time value of money." *In re Milwaukee Cheese Wisconsin, Inc.*, 112 F.3d 845, 849 (7th Cir.1997). In this case, compensation has been deferred for a very long time —so long that the interest on the producers' overcharges now amounts to 160 percent of the principal. *See* Reply Brief of Petitioners (Producers) at 5, 10. The Commission is empowered, by § 502(c) of the NGPA, to make adjustments giving relief from its orders "as may be necessary to prevent special hardship, inequity or an unfair distribution of burdens." 15 U.S.C. § 3412(c). The producers have a list of "equitable" reasons why the Commission should have relieved all of them of having to pay interest: the litigation has gone on forever; the Commission is responsible for much of the delay; the producers relied on the Commission's settled view that the Kansas *ad valorem* tax was a severance tax. We think the Commission rightly brushed these objections aside.

The Commission's legal errors and the snail-like pace of its administrative proceedings are cause for complaint, but are not in themselves grounds for altering the producers' interest obligation. *See Southeastern Michigan Gas Co. v. FERC*, 133 F.3d 34, 42-44 (D.C.Cir.1998). It is the balance of equities between the producers and their customers, not between the producers and the Commission, that matters. As the Commission has recognized, interest is simply a way of ensuring full compensation. *See Public Service Order II*, 82 F.E.R.C. at 61,215. This is why the delay between the time of the customers' injury

and the granting of relief is a reason for awarding interest, not for denying it, at least when the delay cannot be laid at the feet of the customers. *See Milwaukee v. Cement Div. of Nat'l Gypsum Co.*, 515 U.S. 189, 196, 115 S.Ct. 2091, 132 L.Ed.2d 148 (1995); *General Motors Corp. v. Devex Corp.*, 461 U.S. 648, 657, 103 S.Ct. 2058, 76 L.Ed.2d 211 (1983). It is why the producers' contention that they are being penalized for their good faith reliance on the Commission's long-standing treatment of the Kansas tax misapprehends the purpose of awarding interest. Interest is not awarded against someone for conducting litigation in bad faith; it is, as the Commission knew, awarded to make the prevailing party whole. *See National Gypsum Co.*, 515 U.S. at 196-97, 115 S.Ct. 2091.

The Commission gave careful consideration to each of the "equitable" reasons the producers offered for a generic waiver of interest and said this: "granting a generic waiver of interest of the *ad valorem* Kansas refunds ordered by *Public Service* would be inconsistent with the Court's mandate." *Public Service Order II*, 82 F.E.R.C at 61,214. That the Commission correctly read our *Public Service* opinion cannot be doubted. We there rejected the producers' equitable arguments against full refunds back to 1983, arguments the producers now repeat in support of their request for a generic waiver of interest regarding the same period. In holding that the producers "must refund the full amount that they unlawfully collected," 91 F.3d at 1490, we determined that the producers had not established "detrimental reliance," *id.*;[4] that even if they

[4] This part of our *Public Service* decision distinguishes *Panhandle Eastern Pipe Line Co. v. FERC*, 95 F.3d 62 (D.C.Cir.1996), in which we sustained the Commission's order mandating a refund without interest because the Commission's error not only prolonged the litigation, but also caused the losing party to forego a viable alternative means of recovering from the prevailing party. *See id.* at 67-68.

had relied on the Commission's treatment of the Kansas tax, passage of the NGPA and the 1983 petition challenging this treatment rendered their reliance unreasonable, *id.*; and that "we are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recovery of the tax," *id.* In view of these and other portions of our *Public Service* opinion, the Commission properly concluded that it should not grant a generic waiver of interest because, to do so, it would have to assess the equities in a manner contrary to *Public Service*.[5]

Estate of French v. FERC, 603 F.2d 1158 (5th Cir. 1979), which the producers invoke, does not favor a different outcome. The court of appeals held that "equitable considerations" did not allow the Commission to award interest against a petitioner seeking an economic hardship waiver for the seven years it took to decide his claim because a delay of that length was unreasonable per se. *See id.* at 1167-68. Here, by contrast, the Commission acted quite promptly on the producers' petition for a waiver of interest. There may have been untoward delay here, but it occurred between our remand in *Colorado Interstate* and the Commission's reversal of its treatment of the tax. There is an ocean of difference between being required to pay interest on a lawful obligation (as the pro-

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[5] Whether the Commission's determination that *Public Service* "foreclosed the granting of relief on a generic basis to all producers, regardless of their individual circumstances," *Public Service Order II*, 82 F.E.R.C. at 61,214, is inconsistent with its statement that it retains equitable discretion to adjust individual producer liability in cases of hardship, *see id.; see also id.* at 61,217, is a question not before us and one on which we reach no judgment. Our decision today does not affect the Commission's established standards for granting hardship waivers and does not prohibit individual parties from seeking hardship waivers in a proceeding under NGPA § 502(c), 15 U.S.C. § 3412(c).

ducers are being required to do here) and being required to pay interest while waiting for the Commission to decide whether one deserves a hardship waiver (which is what the court refused to allow in *French*).

IV. TAX-ON-TAX

One of the curious features of the complex system by which Kansas taxed the production of natural gas was the way in which assessors "grossed up" the value of the gas by approximately 10 percent to reflect the producers' ability to recover the Kansas tax at the time of sale. *See Ensign Oil & Gas, Inc.*, 71 F.E.R.C. ¶ 61,204, at 61,750 (1995). The producers now argue that the Commission should reduce the amount of their refund liability to their customers by the amount of this "tax-on-tax" because it rested on the false assumption that they could recover the tax and because they now have no way of recouping the inflated taxes they paid to Kansas. We hold that the Commission properly determined that the producers are responsible for refunding the Kansas tax-on-tax.

In terms of equity, the tax-on-tax problem disturbed the balance of equities between the producers and Kansas, not between the producers and their customers. There is no reason why, in the Commission's words, "overcharged consumers should forego refunds they are entitled to, to the extent producers paid more *ad valorem* taxes to Kansas localities than they should have." *Public Service Order II*, 82 F.E.R.C. at 61,219.[6]

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[6] Given this ground of decision in *Public Service Order II*, there is no need for us to address the producers' arguments that the Commission misconstrued *Ensign Oil & Gas, Inc.*, 71 F.E.R.C. ¶ 61,204 (1995), in *Public Service Order I*.

V. REFUND DATE

In *Public Service*, we said that we would "not require refunds of taxes recovered with respect to production before October 1983 because there is before us no controversy over those monies." *Public Service*, 91 F.3d at 1490-91. Our use of the phrase "with respect to production," which appears three times in the opinion, *see id.* at 1490, 1492, has generated some confusion, particularly in view of our decision on the merits that the Kansas tax was not a severance tax attributable to production within § 110's meaning. 91 F.3d at 1482-86. On remand, the Commission interpreted taxes "with respect to production" to mean "revenues collected based upon any tax bill rendered after October 4, 1983," *Public Service Order II*, 82 F.E.R.C. at 61,220; *accord Public Service Order I*, 80 F.E.R.C. at 61,953 n. 25. Because Kansas levied its *ad valorem* tax annually and collected it through a bill sent toward the end of each year, the producers objected to the Commission's interpretation because it appeared to them to impose an additional nine months of liability. *See* Reply Brief of Petitioners (Producers) at 19. We find ourselves in agreement with neither the Commission nor the producers. Both focus on the tax transaction between producers and Kansas rather than the sales transactions between the producers and their customers. Our decision in *Public Service* required the producers to refund all taxes passed through to customers after October 4, 1983. In other words, the phrase "with respect to production" means "when sold."

Public Service used the prepositional phrase "with respect to production" three times to modify three different objects. The opinion first stated that "we do not require refunds of *taxes recovered* with respect to production before October 1983." 91 F.3d at 1491-92 (emphasis added). Here, "taxes recovered" means taxes passed

through at sale because that is how taxes are "recovered." The second instance is this: "Producers are liable to refund all Kansas ad valorem *taxes collected* with respect to production since October 1983." *Id.* at 1492 (emphasis added). Here, the natural first reading of "taxes collected" might be taxes levied by Kansas because we normally think of states, not private entities, as tax collectors. In context, however, the better reading of "taxes collected" is taxes collected from customers through higher prices. The final instance is: "The customers are limited, however, to recovery of *taxes paid* with respect to production since October 1983. . . ." *Id.* (emphasis added). This last sentence focuses most clearly on the sales transaction rather than the tax transaction because it is the customers who are doing the paying. In order to show that this is the correct interpretation, we need to look at the way the taxation and recovery process worked.

During the period in question, Kansas would send a tax bill to the producers near the end of the year assessing a well's raw value during the previous year. *See Public Service*, 91 F.3d at 1484. That value was determined by a number of factors including the volume of the reserve, the physical capital at the well site, and the rate of production. *See id.* at 1484-85. It is also significant that the rate of production factor was averaged over the lengthier of two time periods—three or five years—whenever production had lasted that long. *See id.* at 1484. After receiving the state tax bill for a given year the producers would take advantage of the federal recovery policy by raising their prices in individual transactions to reflect their individual tax liability.

Between October 1983 and January 1984, the producers overcharged customers to recover state taxes assessed against the value of their wells in 1982. The producers seem to argue that one should look only to the tax bill

they received from Kansas in 1984 for the 1983 tax year and then reduce it by roughly 75% (assuming even production over the year).[7] That argument focuses on the tax transaction, which is the wrong transaction. The transaction that caused the harm is the sales transaction, and it is the overcharges made in those individual transactions (plus interest) that the producers must now repay.[8]

VI. KANSAS

The State of Kansas and the Kansas Corporate Commission joined in this litigation to mitigate the "real and severe . . . . impact on the gas industry in Kansas as a whole and the economy of the state of Kansas as a whole." Final Initial Brief of Petitioners (Kansas) at 13. While it may be true that interest refunds could cause some marginal producers to fold, it is hard to see how the people of Kansas have actually been injured. Kansas was able to collect taxes during this entire period (including their "tax-on-tax"); it has enjoyed the time value of this money; and no one is asking the State to pay back anything. If it is important to Kansas to limit the economic damage on marginal producers, it retains numerous avenues for aiding them. It appears, however, the only action taken by Kansas with respect to the producers' refund liability was adverse. *See* KAN. STAT. ANN. § 55-1624 (enacted Apr. 20, 1998). Indeed, some of the producers in this

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[7] An accurate calculation would be far more complex because of variations in production levels, especially when a well is new. *See Public Service*, 91 F.3d at 1483-85; *Colorado Interstate*, 850 F.2d at 773.

[8] We are aware that although our decision reverses the Commission, it might put the producers in a worse position than they would have been if they had not challenged the Commission's starting date for refunds. At oral argument, we suggested this possible outcome to producers' counsel, but despite receiving notice, the producers continued to press their objection to the Commission's date.

case have already petitioned the Commission for equitable relief from losses resulting from the state law. *See* Notice of Motion for Waiver, 63 Fed.Reg. 30,736 (1998).

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For the reasons stated, the Commission's decision regarding the starting date for refunds is set aside and the cases are remanded for the entry of an order prescribing a starting date consistent with this opinion. In all other respects, the petitions for judicial review are denied.

APPENDIX B

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RP97-369-001
PUBLIC SERVICE COMPANY OF COLORADO and
CHEYENNE LIGHT, FUEL AND POWER COMPANY

Docket No. GP97-3-001
AMOCO PRODUCTION COMPANY, ANADARKO PETROLEUM CORPORATION, MOBIL OIL CORPORATION, OXY USA, INC. and UNION PACIFIC RESOURCES COMPANY,

Docket No. GP97-4-001
KANSAS SMALL PRODUCER GROUP

Docket No. GP97-5-001
MESA OPERATING COMPANY

ORDER DENYING REHEARING
(Issued January 28, 1998)

Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, William L. Massey, Linda Breathitt, and Curt Hebert, Jr.

On September 10, 1997 (September 10 order), the Commission issued an order [1] implementing the Court of Appeals' decision [2] that the ad valorem tax levied by the State of Kansas is not a severance tax within the meaning

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[1] 80 FERC ¶ 61,264 (1997).

[2] *Public Service Company of Colorado v. FERC*, 91 F.3d 1478 (D.C. 1996), *cert. denied*, 117 S. Ct. 1723 (May 12, 1997) (*Public Service*).

of section 110 of the Natural Gas Policy Act of 1978 (NGPA),[3] and that refunds would be due from 1983, rather than 1988, as the Commission had ordered in CIG.[4] The September order denied generic requests for waiver of interest from 1983 to 1988, and required first sellers to make refunds from 1983 together with interest. The refunds are to be paid and distributed as directed in the Commission's prior CIG order, except as *CIG* was modified in that order. The order stated, however, that the ruling did not foreclose individual requests for adjustment relief under NGPA section 502(c),[5] and permitted producers to seek an extended payment period for up to five years.

Requests for rehearing, clarification,[6] and requests for a stay were filed by various parties. We previously denied the request for a stay. For the reasons set forth below, and in the September 10 order, the Commission denies rehearing.

Background

In 1983, after passage of the NGPA, several parties filed petitions requesting the Commission to change the prior ruling that natural gas producers may pass through the cost of the Kansas *ad valorem* property tax as an "add on" to the maximum lawful price of gas. In 1974, the Federal Power Commission (FPC), the Commission's

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[3] 15 U.S.C. § 3320 (1988) (repealed).

[4] *Colorado Interstate Gas Company*, 65 FERC ¶ 61,292 (1993), *order denying reh'g and granting clarification*, 67 FERC ¶ 61,209 (1994) (*CIG*).

[5] 15 U.S.C. § 3412 (1988) (repealed).

[6] Colorado Interstate Gas Company (Colorado Gas) filed a Request for Clarification asking that it be permitted to integrate the *ad valorem* tax refunds with its treatment of other accounts, but then withdrew its request after objections were filed.

predecessor, ruled that under the Natural Gas Act (NGA) producer price regulations the Kansas tax could be passed through to purchasers as a production tax.[7] The Commission denied the request, and held that the Kansas tax remained eligible for pass-through under the NGPA.[8] The Commission explained that when Congress enacted NGPA section 110, it used language nearly identical to that employed in the FPC's ruling, and the accompanying Conference Report specified that the statutory language was to be "construed broadly" and could apply to any tax imposed on production, "including an ad valorem tax."

In 1988, the Court of Appeals remanded for further explanation the Commission's order reaffirming that the Kansas tax qualified for passthrough.[9] On remand, the Commission, in *CIG*, held that the Kansas tax was not a production tax eligible for recovery under section 110 as an add-on to NGPA maximum lawful prices. As a remedy, the Commission ordered refunds from June 28, 1988, the date of the Court of Appeals' decision *Colorado*. The Commission explained that before that decision producers reasonably relied on the prior rulings holding that the Kansas tax could lawfully be recovered. After *Colorado*, however, producers were on notice that the Kansas tax might no longer be recoverable under section 110.

Both sides appealed, and the Court, in *Public Service*, upheld the Commission's finding that the tax did not qualify under section 110, but held that the refund period would commence on October 4, 1983, when notice was

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[7] Opinion No. 699-D, 52 FPC 915, 915-16 (1974).

[8] *Sun Exploration & Production Co.*, 36 FERC ¶ 61,093 (1986); *Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987) (*denying rehearing*) (*Sun*).

[9] *Colorado Interstsate Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988) (*Colorado*).

given that the recoverability of the Kansas tax under NGPA section 110 was a question before the Commission. The Court relied on the same legal test as the Commission had, that "when there is a 'substitution of new law for old law that was reasonably clear', the new rule may justifiably be given prospective-only effect in order to 'protect the settled expectations of those who had relied on the preexisting rule,'" (quoting *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544 (D.C. Cir. 1993). However, the Court rejected the Commission's choice of 1988 as the date from which refunds should run under that test. The Court held that once the status of Kansas' *ad valorem* tax as a recoverable production tax was challenged in 1983, producers were on notice that the recoverability of the Kansas tax under NGPA section 110 was at issue. The Court concluded there could be no justified reliance after that date. The Court concluded that "Producers are liable to refund all Kansas *ad valorem* taxes collected with respect to production after October 1983." [10]

The D.C. Circuit denied requests for rehearing filed by the Commission and the producers. After the Supreme Court denied *certiorari*, various producers requested the Commission to grant generic waivers of parts of their pre-1988 refund obligations under section 502(c) of the NGPA, 15 U.S.C. § 3412(c), including waiver of all the interest for the period prior to Court's 1988 *Colorado* decision. Section 502(c) provides that the Commission "may provide for the making of such adjustments, consistent with the other purposes of this Act, as may be necessary to prevent special hardship, inequity, or an unfair distribution of burdens." The producers' petitions for a generic waiver of the payment of interest were based on their reliance on the Commission's original ruling that they could recover the Kansas *ad valorem* tax. How-

[10] 91 F.3d at 1492.

ever, the Commission concluded in its September 10 order that the Court's decision foreclosed the Commission from granting relief on this ground.

The September 10 order explained that the Court of Appeals held in its decision:

> The status of the Kansas tax was expressly drawn into question in 1983 when Northern Natural first petitioned the Commission for a ruling that producers could not lawfully recover the tax under § 110. Once the recoverability of the tax was in dispute, we do not see how the Commission could possibly find that the producers reasonably relied upon continuing to recover it.

Public Service Company of Colorado v. FERC, 91 F.3d 1478, 1490 (D.C. Cir. 1996). Indeed, the order noted that the Court had left little doubt that it would not be sympathetic to any general waiver of the refund since it had stated "absent detrimental and reasonable reliance anything short of full retroactivity (*i.e.* to 1978) allows the producers to keep unlawful overcharges without any justification at all." (*Id.* at 1490). The Commission therefore concluded, in its September 10 order, that the Court's decision left no alternative but to deny the producers' request for an across-the-board waiver of interest on the refund ordered by the Court.

The September 10 order denied the requests for generic relief of all interest for the 1983-1988 period under NGPA section 502(c). Accordingly, the Commission required the refund of principal and interest from October 4, 1983, the date notice of the petitions challenging the recoverability of the Kansas tax was published in the *Federal Register*. However, the Commission also recognized that the refund obligation, with interest included, could present a serious financial problem to individual producers,

particularly small producers, and producers who no longer had producing wells. Therefore, the Commission stated that it would entertain individual requests for adjustment relief for both principal and interest, to alleviate the hardship that is demonstrated in such petitions. The Commission further provided that producers could file requests, with the appropriate supporting data, for permission to make payment of the refund over a period up to five years. The order also rejected a generic limited waiver of principal in a variety of situations, but again did not foreclose individual petitions under NGPA section 502(c), depending upon that petitioner's circumstances. The order required refund of the overcharges within 180 days of issuance of the order.

The Requests for Rehearing

The requests for rehearing argue that the Commission's error in first holding that the Kansas *ad valorem* tax was a permissible add-on led first sellers to continue to collect the tax, and that it would be inequitable to require them to not only repay this overcharge but also to pay interest on that amount. They assert that the September 10 order incorrectly held that the *Public Service* decision forecloses granting a generic waiver of the interest since the instant proceeding involves a request for adjustment relief under NGPA section 502 while *Public Service* only involved the legality of the add-on. They contend that adjustment relief is appropriate in this case, consistent with the grant of adjustment relief by the Commission in other cases.

They also contend that contrary to the holding of the September 10 order they have demonstrated "detrimental reliance," the prerequisite for relief under the Court's analysis in *Public Service*. They contend that there were alternative courses of action that could have been taken in 1983 which supports waiver of interest for the period

preceding 1988. They also argue that the Commission erred in denying waiver of principal in certain specified situations, such as the gross-up of the property tax based on the recoverability of the add-on by the producer, or where the ultimate consumer cannot be found.

Discussion

A. *Generic Request for Waiver of Interest*

At all times when the *ad valorem* taxes at issue were collected, the Commission's regulations provided in § 270.10(e), that prices collected for a first sale of natural gas were collected subject to a general obligation to refund any portion of the price, "together with interest," that exceeded the maximum lawful price. The NGPA, unlike the NGA, includes an express provision concerning "adjustments" from Commission regulations implementing the Act. Thus, NGPA section 502(c) authorizes the Commission to grant adjustments where "necessary to prevent special hardship, inequity, or an unfair distribution of burdens."

Producers argue that the Commission erred in denying the generic waiver of interest for the 1983-1988 period because *Public Service* is not controlling, as the September 10 order held, since that decision involved the legality of the add-on, not whether there should be adjustment relief under section 502(c). The Commission continues to hold that the *Public Service* decision forecloses the grant of an across-the-board waiver of interest on all refunds, regardless of whether the Commission proceeds under its general remedial discretion, or under section 502(c) of the NGPA. However, before addressing the specific contentions of applicants here, the Commission again emphasizes, as it did in the September 10 Order, that it will entertain individual requests for adjustment relief under NGPA section 502(c). The Commission

recognizes that the refund requirement resulting from the *Public Service* decision, with interest included, could pose a serious financial problem to specific producers, particularly small producers, or those who no longer have producing wells. A producer is entitled to relief under NGPA section 502(c) and § 385.1104 of the Commission's regulations, if it can establish that denial of relief "will cause the applicant to suffer special hardship, inequity, or unfair distribution of burdens." All that the September 10 Order held, and this order reaffirms, is that the Court's decision foreclosed the granting of relief on a generic basis to all producers, regardless of their individual circumstances. It did not rule out relief on an individual basis.

We recognize that the producers have sought a generic waiver of interest for adjustment relief pursuant to NGPA section 502(c), and that no section 502(c) adjustment requests were before the *Public Service* Court. However, the contentions advanced by producers for the grant of such adjustment relief are the same contentions that the Court has already rejected in its *Public Service* decision. Since that decision is now final, and is binding upon the Commission, the Commission must act consistent with the Court's mandate. For the reasons discussed below, we reaffirm our conclusion that granting a generic waiver of interest of the *ad valorem* Kansas tax refunds ordered by *Public Service* would be inconsistent with the Court's mandate.

In arguing for a generic waiver of interest pursuant to NGPA section 502(c), Producers contend that the Commission has broad discretion as to the remedy when the Commission's legal error is involved, as it is here, since the Commission reversed its *CIG* ruling in the 1993 remand order. Producers contend that the Commission should exercise that discretion to grant adjustment relief

under NGPA section 502(c) because producers relied on the Commission's 1983 ruling, which the Commission has now changed.

Both in the Commission's prior *CIG* order waiving refunds for the period until 1988, and in the requests for rehearing of the Court's *Public Service* order with respect to the date that when refunds would commence, the Commission and producers relied on all the precedent cited in the instant requests for rehearing concerning the Commission's broad remedial discretion.[11] The Court nonetheless concluded that the Commission must require full refunds of all *ad valorem* taxes collected since 1983. The Court found that, in the circumstances of this case:

> anything short of full retroactivity (*i.e.* to 1978) allows the producers to keep some unlawful charges without any justification at all. The court strongly resists the Commission's implication that the Con-

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[11] For example, in its request for rehearing to the Court, the Commission argued:

> [T]he panel's ruling requires the Commission to impose a fully retroactive refund, a determination that cannot be squared with this Circuit's decades-old rule that the Commission has "broad authority to fashion remedies so as to do equity consistent with the public interest." *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d 105, 109 (D.C. Cir. 1984); . . . *Laclede Gas Co. v. FERC*, 997 F.2d 936, 944 (D.C. Cir. 1993); *Pub. Utils. Comm'n of California v. FERC*, 988 F.2d 154, 163 (D.C. Cir. 1993); *Towns of Concord v. FERC*, 955 F.2d 67, 76 (D.C. Cir. 1992). Indeed, that basic principle was recently reaffirmed when this Court noted that the Commission's "discretion in fashioning an equitable remedy is very broad." *Panhandle Eastern Pipe Line Co. v. FERC*, D.C. Cir. No. 914-1727, slip op. at 10 (issued September 10, 1996) (interpreting NGPA). Petition for Rehearing and Suggestion for Rehearing *in banc* at 9.

> gress intended to grant the agency the discretion to allow so capricious a thing.[12]

In reaching its conclusion, the Court found "the apparent lack of detrimental reliance on the part of producers" to be crucial:

> What could they have done differently if they had known in 1983 that they were not entitled to recover the Kansas Tax? They could not have raised their prices above the maximum lawful level regardless [of] whether the traffic would have borne such an increase.[13]

The Court concluded:

> In these circumstances, we are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recovery of the tax (assuming any party were seeking such extensive relief).[14]

In any event, the Court added that even if producers had relied on the Commission's prior holding that the *ad valorem* tax could be recovered as an add-on, such reliance "would not have been reasonable."[15] The Court explained that "the enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax under the NGA would withstand scrutiny under the NGPA; reliance would have been foolhardy."[16] The Court stated that "absent detrimental and reasonable reliance, anything short of full

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12 91 F.3d at 1490.

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.*

retroactivity (*i.e.* to 1978) allows the producers to keep some unlawful overcharges without any justification at all." [17]

We cannot see how the Court's reasoning would not be applicable to the instant request for generic waiver of interest pursuant to NGPA section 502(c). The Court held that any remedial action short of ordering full refunds would be "capricious." Since the Court denied the Commission's request for rehearing, and the Supreme Court denied the producers' petitions for *certiorari*, the Court's decision is final, and the Commission must carry out the Court's mandate which requires full refunds. Hence, the issue whether the Commission can grant a generic waiver of interest on *ad valorem* tax refunds, turns on whether refunds without any interest would satisfy the Court's requirement of full refunds. The Commission finds that ordering refund of principal only, without interest, cannot be squared with the Court's mandate for full refunds.

In cases where full refunds are required, both the Commission and the courts have consistently treated interest as a necessary element of those refunds. This is because interest is necessary to reflect the time value of money. Order No. 47, which revised the interest rate applicable to refunds, explained that interest on refunds is necessary both to "provide just compensation for the losses, or costs, imposed upon those who have paid excessive rates" and to "reflect the benefits which were available to companies which collected excessive rates." [18]

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[17] *Id.* The Court specifically limited refunds "to recovery of taxes paid with respect to production since October 1983," because no appeliant had preserved its right to relief prior to that date. 93 F.3d at 1492.

[18] *Natural Gas Policy and Procedures, FERC Statutes and Regulations, Regulations Preambles 1977-1981* ¶ 30,083, at p. 30,546

Thus, the September 10 order, in denying the request for a generic waiver of interest, adhered to the normal and customary ruling that:

> Interest, which merely represents use of the money, is ordinarily part of the refund of any overcharge, absent compelling reasons for not requiring its payment to the injured party.[19]

That interest is an inherent part of a refund, is clearly seen in the Court's decision in *Panhandle Eastern Pipe Line Co. v. FERC*.[20] In that case, the Court affirmed a Commission order under the NGA waiving interest on the pipeline's refunds of Order No. 94 costs [21] which the pipelines had direct-billed in violation of the filed rate doctrine. However, *Panhandle's* approval of the Commission's waiver of interest turned on the Court's finding that, in the circumstances of that case, full refunds of the Order No. 94 costs were not required, rather than on any notion that the Commission has more leeway to waive interest than principal. Indeed, the Court expressly equated the Commission's waiver of interest with waiver of a portion of the principal amount of the refunds. The Court stated:

> The Commission purported to resolve the dispute between the Pipelines and the Customers by first holding the pipelines liable to the Customers for the

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(1979), *aff'd, United Gas Pipe Line Co. v. FERC*, 657 F.2d 790 (5th Cir. 1981). Order No. 47 also stated that a third purpose of requiring interest was to avoid providing incentives for parties to prolong litigation.

19 80 FERC at p. 61,951.

20 95 F.3d 62 (D.C. Cir. 1996) (*Panhandle*).

21 Order No. 94 permitted producers to recover certain production-related costs as an add-on under NGPA section 110. The NGA governed the pipelines' pass-through of these costs.

> monies improperly collected but then excusing the Pipelines from paying interest on those sums. Because the principal and interest at stake are roughly equal, however, the result is roughly the same as it would be if the Commission had ordered the Pipelines to refund only half of what they unlawfully collected, plus interest.[22]

In contrast, in *Public Service* the Court stated that producers should be "required to disgorge every dollar they received in recovery of the tax" [23] but limited back only to 1983 because no party sought recovery back to 1978.

Accordingly, we see no grounds on which to waive the interest merely because *Public Service* did not specifically order interest on the refunds. Requiring interest is implicit in that opinion, particularly since the Court repeatedly stated that producers must "refund the full amount that they unlawfully collected." [24]

A number of parties argue that they have demonstrated "detrimental reliance," so that adjustment relief is warranted. The Court, by use of that term, was referring to an alternative course of conduct that the producers could have pursued if they "had known in 1983 that they were not entitled to recover the Kansas tax." [25] Rather than focusing on this question, the detrimental reliance asserted by these parties consists of the treatment of the Kansas *ad valorem* tax by the FPC, and the Commission's initial rulings on that tax after passage of the NGPA.[26]

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22 *Panhandle*, 95 F.3d at 67.

23 91 F.3d at 1490.

24 *Id.*

25 *Id.*

26 Producers cite *Independent Oil & Gas Association of West Virginia*, 7 FERC ¶ 61,094, at p. 61,143 (1979) (applying to sales

These are the same facts presented to the *Public Service* Court. That Court held that with the enactment in 1978 of the NGPA, "a substantially new regulatory regime," reliance on the prior rulings "would have been foolhardy." Moreover, the Court stated that if that "were not enough," in light of the filing of the petition in 1983 challenging the recoverability of the Kansas tax under the NGPA, "we do not see how the Commission could possibly find that producers reasonably relied upon continuing to recover [the tax]."[27] Thus, even if producers could show that they relied on the prior rulings, and had foregone alternative courses of conduct in reliance on those rulings, the Court has held that such reliance would not have been reasonable. To justify the grant of generic adjustment relief, not only must it be shown that reliance was "detrimental," but that it was reasonable. This, the Court held, could not be the case here.

We recognize that the rehearing applicants are now seeking a generic waiver of interest on the 1983-1988 refund through requests for adjustment relief under NGPA section 502(c), and the Court was reversing the Commission's decision to waive all refunds, both principal and interest, for that period, based on its general remedial discretion. However, we cannot see how the same reliance, that in the context of waiving all refunds for the 1983-1988 period the Court concluded was foolhardy, can somehow be transformed into reliance that would justify granting generic adjustment relief of interest only pursuant to NGPA section 502(c).[28]

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under the NGA); and *Trio Petroleum Corp.*, 18 FERC ¶ 61,203, at p. 61,412 (1982) (applying to sales under the NGPA).

[27] 91 F.3d at 1490.

[28] The Indicated Producers' reliance on *Public Utilities Commission of California v. FERC*, 988 F.2d 154, 163 (D.C. Cir. 1993) does not support their argument. That case, and similar other

With reference to the Court's finding of a lack of detrimental reliance, no party had specified with particularity what it would have done differently. Thus none responded to the Court's statement in *Public Service* that no "party has even roughly quantified the harm (*e.g.*, the expenditures made and lost in detrimental reliance upon being able to recover the Kansas tax) that the producers might suffer should they have to refund the full amount they unlawfully collected." [29] However, the State of Kansas argues that in its petition it had shown detrimental reliance.[30] It asserts that had the Commission acted promptly on the 1983 petition and ruled then, as it did later, that the Kansas tax was not a legal add-on under NGPA section 110, there would have been "two options available to Kansas to take action to recast the *ad valorem* tax in a form which would satisfy the Commission's tests (tests only finally adopted in 1994) and/or to revise the property value consideration used in the *ad valorem* tax calculation." [31]

We find that this does not satisfy the Court's query. The options described are not actions that producers

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cases noting the broad Commission discretion in the area of remedy, were cited by the Commission to the *Public Service* Court, but did not sway the Court to permit the 1988 commencement refund date, *supra*, n.11. Similarly, *Boston Edison Co. v. FERC*, 856 F.2d 361 (1st Cir. 1988), and *Southwestern Public Service Co. v. FERC*, 842 F.2d 1204 (10th Cir. 1988), cited by Indicated Producers, are inapposite. Both relate to the Federal Power Act, not the NGPA. Moreover, each declined to permit retroactive application of a Commission ruling, but here, in *Public Service*, the Court specifically determined that issue, and required retroactive application of the Commission's ruling, even further back than the date the Commission sought.

[29] *Id.*

[30] The Indicated Producers adopt the State of Kansas' contention as well.

[31] Kansas Rehearing Request at 6.

could have taken, but rather what others, such as the State of Kansas, might have done. The alternative course of action in *Panhandle,* which the Commission considered in waiving interest, was recovery of the disputed costs through the PGA mechanism, a mechanism sanctioned by the Commission, and under its jurisdiction. In *Panhandle,* the pipelines followed the Commission's ruling in collecting certain funds under a method subsequently ruled illegal. Had the Commission not authorized the illegal method, the pipelines could have collected the funds under the legal PGA method. In this case, there was no other method available to collect the *ad valorem* tax as an add-on. Moreover, there is no assurance that anything would have been done by the Kansas legislature to change the *ad valorem* tax. The Texas *ad valorem* tax, which the Court considered similar to Kansas',[32] had always been held as not qualifying for add-on treatment, yet that State never changed its *ad valorem* tax to attempt to qualify it as an add-on. The Commission's current ruling merely places Kansas producers in the same position as Texas producers had always been. Further, even after the Court's 1988 ruling in *Colorado,* which clearly put the continuing validity of the prior ruling in question, there was no change in the Kansas *ad valorem* tax. Accordingly, we conclude that there has been no showing of detrimental reliance which would justify a generic waiver of interest for the 1983-1988 period. Moreover, there has been no showing of financial hardship in general that would warrant adjustment relief.

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[32] In *Mobil Oil Corp.*, 55 FPC 917, at 918 (1976), the FPC found that Texas' *ad valorem* tax was not eligible for add-on treatment under Opinion No. 699. In *Sun, supra,* the Commission affirmed that ruling, as well as the FPC's ruling on the Kansas tax under the NGPA. In *Colorado,* 850 F.2d at 774, the Court remanded the Commission"s [sic] ruling on the Kansas tax because of "the Commission's dissimilar treatment of evidently identical cases," referring to the Kansas and Texas *ad valorem* taxes.

The Indicated Producers raise a number of other arguments that they claim warrant granting generic relief here. First, they refer to the State of Kansas' petition in Docket No. GP97-3-000 which they contend demonstrated that the imposition of interest will have a material adverse affect on Kansas producers, with specific reference to wells with low production, known as stripper wells. However, that is an issue to be determined on a case-by-case basis, with the producer establishing the required hardship under section 502(c). It is not a basis for generic interest relief. Generic relief would be applicable to all producers, those with high volume as well as low volume producers.

Next, Indicated Producers assert that much of the gas that was sold was "old gas" subject to price ceilings that were eventually held by the Commission in Order No. 451 to be "unjust and reasonable." [33] Indicated Producers argue that the original burden on producers caused by the artificially low price ceiling on old gas would be compounded by requiring the refund ordered in this case, particularly with the imposition of payment of interest on the refunds. Thus, they argue, relief is appropriate to prevent "unfair distribution of burdens" under section 502(c).

The burden referred to by the Indicated Producers is the low ceiling price for "old gas." Order No. 451, adopted by the Commission in 1986, addressed that problem by permitting an increase in the ceiling price for "old gas." However, this is not a basis for depriving consumers of the Court-ordered refund in this case. In the *Btu Refund Case,* the Court of Appeals refused to permit producers to offset against the Btu refund any claims they had against the refund recipient.[34] We see no basis on

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[33] *FERC Statute & Regulation, Regulations Preambles 1986-1990* ¶ 30,701, at p. 30,216 (1986).

[34] *Interstate Natural Gas Association of America v. FERC,* 756 F.2d 166 (D.C. Cir. 1985).

which to permit producers to withhold a portion of the *ad valorem* tax refund based on the assertion that the price that Congress established for the gas sold to consumers during the period in question was too low.

The Indicated Producers also argue that denial of the requested generic waiver of interest is inconsistent with the very grant of that type of relief in cases such as *Panhandle, Estate of French*, 603 F.2d 1158 (5th Cir. 1979), and *Great Lakes Gas Transmission Company Limited Partnership*.[35] The September 10 order discussed the first two cases and we will not repeat that discussion.[36]

The Indicated Producers argue that in *Great Lakes* the Commission, while ordering retroactive surcharges and refunds to certain customers, waived the payment of interest on such refunds, and the basis of waiving interest was that the Commission's legal error caused a large refund payment that had to be paid at one time, instead of spreading the payment over a number of years. On January 16, 1998, the Court of Appeals reversed the Commission's waiver of interest in *Great Lakes*.[37] In any event, *Great Lakes* is inapposite for a number of reasons. *Great Lakes* was a case under the NGA, and the issue was whether there should be rolled-in or incremental rates for the costs of expansion on the pipeline. The Commission initially held that there should be incremental rates. After the Court questioned this ruling, on remand, the Commission changed its ruling, and directed that the pipeline must charge rolled-in rates for the expansion. The customers who had paid the higher incremental rates re-

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[35] 72 FERC ¶ 61,081 (1995), *reh'g denied*, 75 FERC ¶ 61,089 (1996), *reh'g denied*, 76 FERC ¶ 61,157 (1996).

[36] 80 FERC at pp. 61,951-53.

[37] *Southeastern Michigan Gas Company and Michigan Gas Company v. FERC*, No. 96-1200 (D.C. Cir. Jan. 16, 1998).

ceived a refund from the pipeline which was funded through a surcharge to the customers who had paid the lower rates. The remedy thus was essentially between two groups of customers, not as it is here, between a producer and the overcharged customers. In *Great Lakes* the Commission's concern was to protect customers from the "rate shock" that would have ensured if interest was added to the principal that now had to be recovered from the pipelines' customers paying the surcharge. Absent the Commission's legal error, this amount would have been spread over the entire period rather than in one payment. The Commission held that excluding interest "should ease the adverse effects" [38] on the pipeline's customers of the legal error, consistent with the Commission's obligation of protecting its prime constituency, the consumer of the regulated item. However, the Court was not persuaded, and ordered the Commission to require interest even in the situation involved in *Great Lakes*.

The Commission wishes to restate that the Court's decision in this case held that producers had received more than the maximum lawful price, and that they were required to refund all overcharges. The September 10 order implements that decision. Interest is ordinarily required in order to compensate the injured party for the time value of the funds it was deprived of, and a reading of the *Public Service* opinion inevitably leads to the conclusion that interest on the refunds is necessary to carry out the Court's mandate. The September 10 order places Kansas producers in the same position as producers in other states who were not permitted to collect the *ad valorem* tax as an add-on under NGPA section 110. That we are denying the generic request for waiver of interest or principal is no indication how we would rule on indi-

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[38] 72 FERC at p. 61,430.

vidual petitions for relief based upon the circumstances of that particular petitioner.

B. *Requests for Generic Waiver of Portions of Principal*

The September 10 order rejected the generic request for a limited waiver of principal in three specific situations. The requests for rehearing assert that rehearing should be granted as to all three. We disagree, and will briefly discuss each.

1. *Royalty payment*

Producers had requested that there be a limited waiver of principal where the royalty owner who was paid based on the assumption that the Kansas *ad valorem* tax was an add-on under NGPA section 110 cannot be located, the amounts are unrecoverable, or the amounts are *de minimis* and the cost of recovery would exceed the amount to be recovered.

The September 10 order denied the generic request but recognized that the royalty owner refund may present problems, and stated that the Commission would take the same approach to this issue as it took when that issue arose with respect to Btu refunds.[39] Accordingly, the order stated that the waiver of a refund on grounds of uncollectability from royalty owners would be considered on a case-by-case basis, and the standards for determining whether a refund obligation is uncollectible from a royalty owner would be those set forth in *Wylee Petroleum Corporation*.[40] No reason has been advanced why this ruling should be changed.

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[39] *See Refunds Resulting from Btu Measurement Adjustment*, Order No. 399-A, *FERC Statutes & Regulations, Regulations Preambles 1982-1985* ¶ 30,612, at p. 31,217 (1985).

[40] 29 FERC ¶ 61,014 (1985).

Plains Petroleum contends that the September 10 order did not address the *de minimis* contention, and urges the Commission to adopt it now. It asserts that with the passage of time, the royalty interest has been divided into small fractions so that recovery from these numerous royalty owners presents an administrative burden and substantial costs, and it argues that there should be $500 cut-off point per royalty owner.

We reaffirm our ruling that this type of adjustment should be determined on an individual basis. To the extent that the working interest owner pays these royalty owners the royalty due each one, we are hard-pressed to understand why the working interest owner cannot use the same information to recover the refund from that party. If the passage of time changes this, the producer should file an individual petition setting forth the facts demonstrating why waiver would be proper.

2. *Payment to the Overcharged Customer*

Producers argued that where the actual customer who paid the overcharge cannot be located, there should be a waiver of that amout of the refund, because otherwise the pipeline would retain that amount of the refund. However, the September 10 order specifically stated that "the pipelines will be required to pay over all refunds they receive to their customers." [41]

Of course, with the passage of time, making repayment to the exact customer that was overcharged may not be possible. Nevertheless, the refunds that the pipelines re-

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[41] 80 FERC at p. 61,954. *Natural Gas Pipeline Company of America* in Docket No. RP98-38-000, and *El Paso Natural Gas Company* in its request for rehearing, discussed *infra* Part C, contend that under Commission-approved settlements, customers have waived their right to this refund. This issue will be addressed in the docket involving that pipeline's Statement of Refunds Due.

cover will be flowed through, and thus the pipelines will not be keeping any part of the refund.

The Indicated Producers pose a number of scenarios in which it might be difficult to determine which pipeline customer should receive the refunds received by that pipeline. However, this does not undermine the Commission's conclusion in the September 10 order. The pipeline must file a refund report indicating who received the refunds and parties may protest that filing. Any question of whether refunds were properly distributed can be determined at that time.

3. *The Gross-Up Issue*

Producers urged that they should be permitted to waive the amount of refunds equal to the amount of overpayment of property taxes because of the added value of the property from the add-on aspect of the *ad valorem* tax. The Commission had previously rejected this argument in *Ensign Oil & Gas*[42] (*Ensign*) with respect to the refund for the period after 1988, stating that the producer could have paid the tax under protest. The September 10 order recognized that in *Ensign* the Commission had stated that the producer should not have relied on the Commission's prior ruling after the Court's 1988 decision in *Colorado*, but nevertheless, the Court's discussion in *Public Service* would be applicable here as well. Thus, producers should have filed any tax under protest once the petition was filed in 1983 questioning the continuing validity of the FPC's ruling on the Kansas tax.

Producers argue that the protest procedures make no sense because until the Commission held the add-on invalid in the 1996 *GIG* ruling, a producer had no basis for its protest. Thus, they contend that while the filing of

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42 71 FERC ¶ 61,204 (1995).

a petition could, as the Court held, provide "notice," it is not a basis to protest a tax. Moreover, they assert that the passage of time makes it impossible to seek recovery from the taxing authority since at issue are taxes paid as far back as 1984, and no protest would be held open for thirteen years.

The Commission understands the problem that producers are faced with. However, producers are requesting that overcharged consumers should forego refunds they are entitled to, to the extent producers paid more *ad valorem* taxes to Kansas localities than they should have. Whether or not producers are correct on the tax recovery procedure in Kansas is not for the Commission to determine. Moreover, Kansas has urged that the equities support adjustment relief here. However, we suggest that producers should seek equitable relief from the Kansas taxing authorities, not from the overcharged gas customer. Accordingly, we deny rehearing.

C. *Refund Commencement Date*

The Indicated Producers question the clarification in footnote 25 of the September 10 order that the refund relates to revenues collected based upon any tax bill rendered after October 4, 1983, rather than production after that date. However, this is the clarification we directed in the *CIG* order, and since *Public Service* did not take issue with it, we find no reason to change that clarification. That clarification stated as follows:

> We find merit in CIG's request that we clarify what the *CIG* effective date means. CIG notes that the *ad valorem* tax is a tax on the assessed value of the property in January of the year of taxation, but the tax bill is usually not received until November of that year. CIG asserts that the tax is not on the

producer's sales, so that the ruling should be applicable to reimbursement of the *ad valorem* portion of any tax bill received after the applicable date of the new ruling. Thus, CIG argues the entire tax for 1988 would be covered by our ruling, assuming the tax bill was received after June 28, 1988. We find merit in this argument and will modify the refund provision in the order accordingly so that ordering paragraph (E) is modified to be applicable to any revenues collected in excess of the applicable maximum lawful price based upon any tax bill rendered after June 28, 1988.[43]

D. *The Request for Rehearing by El Paso Natural Gas Company*

El Paso Natural Gas Company filed a motion to intervene outof-time [sic], and a request for rehearing. El Paso requests that the Commission determine that El Paso will not have to flow through any refund because under a Commission-approved settlement [44] customers have waived their right to any refund from the Kansas *ad valorem* tax, or clarify that a pipeline will not be precluded by the September 10 Order from demonstrating to the Commission that it should not be required to flow through to its customers any Kansas *ad valorem* tax refunds that it receives.

We deny the motion for late intervention because of a failure to show good cause as required by 18 C.F.R. § 385.214(d) (1997). Moreover, we would deny the request for rehearing since El Paso's request is specific

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[43] *CIG*, 67 FERC ¶ 61,209, at p. 61,660 (1994).

[44] El Paso cites to *Stipulation and Agreement in Settlement of Rate and Related Proceedings, El Paso Natural Gas Company*, Docket No. RP88-44-000, *et al.*, 54 FERC ¶ 61,316, *order on reh'g*, 56 FERC ¶ 61,290 (1991).

to it, and is not a generic request. As required by the September 10 order, El Paso filed a Statement of Refunds Due in Docket No. RP98-44-000, and protests were filed in that docket. The Commission is establishing procedures for addressing the issue of El Paso's flowthrough of the refunds in an order in that proceeding. With respect to El Paso's request for clarification, the Commission is also issuing a contemporaneous order clarifying the procedures with respect to the Kansas *ad valorem* tax refunds.

The Commission orders:

The requests for rehearing are denied.

APPENDIX C

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RP97-369-000
PUBLIC SERVICE COMPANY OF COLORADO AND
CHEYENNE LIGHT FUEL AND POWER COMPANY

Docket No. GP97-3-000
AMOCO PRODUCTION COMPANY, ANADARKO PETROLEUM CORPORATION, MOBIL OIL CORPORATION, OXY USA, INC. AND UNION PACIFIC RESOURCES COMPANY

Docket No. GP97-4-000
KANSAS SMALL PRODUCER GROUP

Docket No. GP97-5-000
MESA OPERATING COMPANY

ORDER DENYING PETITIONS FOR ADJUSTMENT AND ESTABLISHING PROCEDURES FOR THE PAYMENT OF REFUNDS

(Issued September 10, 1997)

Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, and William L. Massey.

This order addresses a number of filings relating to the Commission's decision [1] that the *ad valorem* tax levied by the State of Kansas is not a severance tax within the meaning of section 110 of the Natural Gas Policy Act of

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1 *Colorado Interstate Gas Company*, 65 FERC ¶ 61,292 (1993), *order denying reh'g and granting clarification*, 67 FERC ¶ 61,209 (1994) (*CIG*).

1978,[2] (NGPA), and the Court of Appeals' decision that refunds would be due from 1983, rather than 1988, as we had ordered.[3] For the reasons set forth, first sellers will be required to make refunds from 1983 together with interest, and the refunds are to be paid and distributed as directed in our prior *CIG* order, except as modified by this order.

Background

In 1974, the Federal Power Commission (FPC), the Commission's predecessor, allowed producers to increase the otherwise applicable just and reasonable rate under the Natural Gas Act (NGA) in order to recover "production, severance, or similar taxes."[4] Kansas imposed an *ad valorem* tax on producers, and the FPC held that tax qualified as a recoverable production tax.[5]

In 1978, Congress enacted the NGPA which imposed certain statutory ceilings for first sales of natural gas. NGPA section 110 allowed producers to recover charges in excess of the applicable statutory ceilings "to the extent necessary to recover * * * State severance taxes attributable to the production of" natural gas. Section 110 defined a severance tax for those purposes as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas."

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[2] 15 U.S.C. § 3320 (1988) (repealed).

[3] *Public Service Company of Colorado v. FERC*, 91 F.3d 1478 (D.C. 1996), *cert. denied*, Nos. 96-954 and 96-1230 (65 U.S.L.W. 3751 and 3754, May 12, 1997) (*Public Service*).

[4] Opinion No. 699, *Just and Reasonable National Rates for Sales of Natural Gas*, 51 FPC 2212, 2301-2302, reh'g denied in relevant part, 52 FPC 1604 (1974), *aff'd sub nom., Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976).

[5] Opinion No. 699-D, *Just and Reasonable National Rates for Sales of Natural Gas*, 52 FPC 915 (1974).

In 1983, after passage of the NGPA, several parties filed petitions with the Commission asserting that the FPC's 1974 order should be abandoned and the recovery of the Kansas *ad valorem* tax should be disallowed under NGPA section 110. The Commission denied those petitions in *Sun Exploration & Production Co.*, 36 FERC ¶ 61,093 (1986), *reh'g denied sub nom., Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987) (*Sun Exploration*),[6] and authorized producers to charge prices in excess of the NGPA statutory price ceilings in order to recover the costs of the Kansas *ad valorem* tax. In 1988, the Court of Appeals granted a petition for review and remanded the proceeding so the Commission could explain its decision on the Kansas tax by reference to any cogent theory of what makes a tax "similar" to a production or severance tax under NGPA section 110.[7]

On remand, the Commission concluded that the tax should be viewed as a property tax, and not as a severance tax eligible for recovery under NGPA section 110. As a remedy, the Commission ordered refunds of those taxes that had been included in the rates producers charged after June 28, 1988, the date of the Court of Appeals' decision in *Colorado Interstate*. The Commission explained that before that decision, producers reasonably relied on Commission orders holding that the Kansas tax could lawfully be recovered. After *Colorado Interstate*, however, producers were on notice that the Kansas tax might no longer be recoverable under section 110. Both

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[6] In *Sun Exploration*, the Commission adhered to the FPC's ruling in *Mobil Oil Corp.*, 55 FPC 917 (1976), that the Texas *ad valorem* tax was not a severance or production tax, and thus was not eligible for NGPA section 110 add-on treatment. That ruling was not appealed.

[7] *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769, 773 (D.C. Cir. 1988) (*Colorado Interstate*).

sides appealed, and the court, in *Public Service*, upheld the Commission's finding that the tax did not qualify under section 110, but held that the refund period would commence October 1983, when notice was published in the *Federal Register* of the petition that was filed with the Commission challenging the prior FPC ruling. The court relied on the same legal test as the Commission had, that "when there is a 'substitution of new law for old law that was reasonably clear,' the new rule may justifiably be given prospective-only effect in order to 'protect the settled expectations of those who had relied on the pre-existing rule,'" (quoting *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544 (D.C. Cir. 1993). However, the court rejected the Commission's choice of 1988 as the date from which refunds should run under that test. The court held that once the status of Kansas' *ad valorem* tax as a recoverable production tax was challenged in 1983, producers were on notice that the recoverability of the Kansas tax under NGPA section 110 was at issue. The court concluded there could be no justified reliance after that date. The court concluded that "Producers are liable to refund all Kansas *ad valorem* taxes collected with respect to production after October 1983." [8]

The Instant Filings

On May 12, 1997, after the Supreme Court denied *certiorari*, a number of producers [9] (Producers) filed a petition for an adjustment under NGPA section 502(c), and subpart K of the Commission's Rules of Practice and Procedure, requesting pre-remittance relief from the requirement to pay interest on all refunds of Kansas *ad*

[8] 91 F.3d at p. 1492.

[9] The producers are Amoco Production Company, Anadarko Petroleum Corporation, Mobil Oil Corporation, OXY USA, Inc. and Union Pacific Resources Company.

valorem taxes that may be due for the period between October 4, 1983, and June 28, 1988. The October 4, 1983 date represents the date from which refunds are due under the Court of Appeals' *Public Service* decision, and the June 28, 1988 date is the date under the Commission's *CIG* decision. On May 16, 1997, Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company (Customers) filed a request that the Commission issue an order establishing procedures for the payment of the Kansas *ad valorem* tax refund. The suggested procedures would modify the procedure set forth in the Commission's 1994 *CIG* order.

On June 24, 1997, the Kansas Small Producer Group (Small Producer Group) in Docket No. GP97-4-000, and Mesa Operating Company (Mesa) in Docket No. GP97-5-000, filed petitions for an adjustment under NGPA section 502(c), requesting an adjustment to their potential liability to pay Kansas *ad valorem* tax refunds with respect to gas production between October 4, 1983, and June 28, 1988. They assert that the Commission should grant at least a limited waiver of refund principal, plus a total waiver of the interest otherwise due on refunds, for the 1983 to 1988 period.

Notice and Protests

The parties filing motions to intervene in Docket No. RP97-369-000 are listed in appendix A, those in Docket No. GP97-3-000 in appendix B, those in Docket No. GP97-4-00 in appendix C, and those in Docket No. GP97-5-000 in appendix D. Timely filed motions are granted pursuant to rule 214, 18 C.F.R. § 385.214. Timely filed motions not listed in the appendixes [sic] are also granted pursuant to 18 C.F.R. § 385.214. Any motions to intervene out-of-time listed in the appendices are granted pursuant to 18 C.F.R. § 214(d), since the Commission finds

that granting intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. Basically, the parties supporting the three petitions in Docket Nos. GP97-3, 4, and 5, object to the Customers' request, and the parties supporting the Customers' request protest the petitions.

Discussion

A. *The Petitions for Adjustment*

Producers, in Docket No. GP97-3-000, assert that in light of the protracted regulatory delays in resolving conflicting contentions regarding the recoverability of Kansas *ad valorem* taxes, assessing interest on any refunds with respect to production between October 4, 1983, and June 28, 1988, would be inequitable. This they argue, would only serve to compound the unwarranted economic injury to Producers. They add that the relief sought, the waiver of interest, is appropriate because producers have not been unduly enriched by being permitted to pass through Kansas *ad valorem* tax obligations to buyers.

Producers argue that NGPA section 502(c) provides the basis for making adjustments, and empowers the Commission to grant relief from Commission rules or orders under the NGPA. Producers also argue that the requirement to pay interest on NGPA refunds is not stated in the NGPA and may be waived in appropriate circumstances. Moreover, they state that the Commission has in the past granted requests for a waiver of interest and principal attributable to Kansas *ad valorem* tax refunds, citing *Robert H. White*, 71 FERC ¶ 61,185, at p. 61,662 (1995), and they contend that other Commission decisions also support granting the requested relief, citing *Ensign Oil & Gas Inc.*, 71 FERC ¶ 61,204 (1995) (*Ensign*). Finally, they assert that nothing in the *Public*

Service opinion bars the relief sought since that opinion does not expressly address either issues relating to the payment of interest on Kansas *ad valorem* tax refunds for the periods at issue in this case, or the propriety of granting relief from that obligation under NGPA section 502(c).

In essence, Producers urge that it would be inequitable to require the payment of interest and it would "compound the unwarranted economic injury" to the Producers because they detrimentally relied on prior Commission rulings.[10]

At this juncture, the Commission is not writing upon a clean slate. In *CIG* we stated that determining the applicable date of the Commission's "new ruling raises a difficult and complex question." [11] We explored possible alternative dates, and as the court stated in *Public Service* "conclude[d] that requiring refunds back to the date of our decision in June 1988 [*Colorado Interstate*] properly balances the producers' equitable claim to notice against the consumers' *legal* right to receive a refund of all unlawfully collected charges." [12] However, the court rejected this balancing, and we now must implement that decision.

Producers' arguments for a generic waiver of interest here are not dissimilar from the ones that were the basis of the Commission's decision to choose 1988 as the date when refunds would commence. In doing so the Commission agreed to waive any refund for the period prior to 1988, holding that before that date Producers reasonably relied on the Commission's orders permitting recovery of the Kansas *ad valorem* tax as a section 110 add-on.

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[10] Petition at pp. 10-11.

[11] 67 FERC at p. 61,657.

[12] 91 F.3d at p. 1489.

Once principal was not required to be refunded, obviously neither was any interest due. Producers here are now urging the same arguments concerning reliance on the Commission's prior orders to support waiver of interest, arguments which the Commission used to justify waiving any refund prior to 1988. However, in *Public Service*, the Court agreed with those who had argued that the producers "never explain how their 'settled expectations' led them into detrimental reliance upon being able to recover the Kansas tax." [13] The court held that there was an "apparent lack of detrimental reliance on the part of producers" because it was never spelled out what they would "have done differently if they had known in 1983 that they were not entitled to recover the Kansas tax." [14] The court concluded:

> In these circumstances, we are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recovery of the tax (assuming any party were seeking such extensive relief).[15]

In fact, the court found that there was no basis on which the producers could realistically claim detrimental reliance. The court pointed out that "the enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax under the NGA would withstand scrutiny under the NGPA; reliance would have been foolhardy." [16] If that was not sufficient, once the FPC decision was drawn into question by the 1983 petition, producers could no longer

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[13] 91 F.3d at p. 1490.

[14] *Id.*

[15] *Id.*

[16] *Id.*

rely upon the prior ruling to justify retention of the overcharge, whatever the final ruling on the petition. The court added "absent detrimental and reasonable reliance, anything short of full retroactivity (*i.e.*, to 1978) allows the producers to keep some unlawful overcharges without any justification at all." [17]

We recognize that the Court did not specifically address the issue of waiver of interest. Nevertheless, the Court expressed its doubt that Congress intended to grant the Commission any discretion to permit producers to keep any part of the overcharges, even overcharges going back to 1978. We find the court's holding on detrimental reliance instructive and indicative of the analysis required on whether the Commission should, or could, waive interest on the overcharges.

Producers' petition does not address the concerns expressed by the Court in *Public Service* as to why producers should not disgorge all overcharges. Interest, which merely represents use of the money, is ordinarily part of the refund of any overcharge, absent compelling reasons for not requiring its payment to the injured party. For example, when the court reversed our rule concerning Btu measurement adjustments in the calculation of NGPA ceiling prices,[18] the Commission rejected requests that it grant a generic waiver of interest on the resulting refunds. The Commission stated:

> The Commission is not persuaded that equity favors a general waiver of the interest requirement although it does acknowledge that waivers may be appropriate in specific cases. Specifically, interest charges reflect a reimbursement to the rightful owner of the value

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[17] *Id.*

[18] *Interstate Natural Gas Association of America v. FERC*, 716 F.2d 1 (D.C. Cir. 1983).

> of the use of funds held by first sellers. Fairness to consumers dictates that first sellers pay interest on the Btu refund amounts owed.[19]

The same reasoning applies here.

The Commission has also discussed the question of interest on the refund of the Kansas *ad valorem* tax overcharges in *Ensign*. In *Ensign* the producer argued, as producers argue here, that it had not been unjustly enriched since it never had use of the money but merely was an intermediary in the payment of these taxes, and thus the imposition of interest is not necessary to avoid unjust enrichment. Moreover, the producer contended that it, (and other producers) have been prejudiced by the Commission's delay and have suffered increased refund liability and additional loss because of that delay. We rejected the arguments stating:

> The simple fact is that Ensign collected more than the MLP and our order requires it to refund the amount to consumers who paid the excess amount. That the amount represents a tax that Ensign paid does not change the relevant consideration that Ensign received money it was not entitled to. The obligation to pay interest merely charges Ensign for the use of that money.[20]

Nor does *Panhandle Eastern Pipe Line Corp. v. FERC*, 95 F.3d 621 [sic] (D.C. Cir. 1996) (*Panhandle*) lend support to Producers' position. In that case the Commission originally held that pipelines could direct bill their customers for past production-related costs billed to the pipelines

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[19] *Refunds Resulting from Btu Measurement Adjustment*, Order No. 399-A, *FERC Statutes & Regulations*, Regulations Preambles [1982-1985] ¶ 30,612 at p. 31,207 (1985).

[20] 71 FERC at p. 61,749.

by First Sellers in excess of the MLP under NGPA section 110, which are treated like the production and severance tax at issue in this proceeding. Several years later and after a number of court remands, the court held that this method was unlawful as violative of the filed rate doctrine, and refunds would be necessary to the injured parties.[21] Upon remand, the Commission held that its prior decision to permit direct billing of the costs had induced the pipelines to forego a legal alternative method to recover these costs, which was through the Purchase Gas Adjustment (PGA) mechanism, which was no longer available. However, it was not clear how much the pipelines could have recovered through that method. The Commission accordingly directed the pipelines to refund the principal but not interest. This cut the refund in half. As the court explained in affirming the Commission's decision, under that ruling "the customers get back the principal amount of the unlawful charges they paid, but the pipelines get the time value of the money for the period during which they had use of it—a roughly even split of the total sum in dispute." [22] This seemed only fair as a "solution to a problem for which [the Commission] forthrightly accepts the blame." [23]

In this case Producers, unlike the pipelines in *Panhandle*, did not have an alternative course of action available to them, and thus the Commission's prior decision did not induce them to act as they did. A first seller could only collect up to the maximum lawful price (MLP). The Commission's decision allowed them to collect more than the MLP, which they must now refund. Had the Com-

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21 *Columbia Gas Transmission Corp. v. FERC*, 895 F.2d 791 (D.C. Cir. 1990).

22 95 F.3d at p. 67.

23 *Id.*

mission ruled then, as it rules now, Producers would not have collected the excess over the MLP. By requiring refund of the overcharges, plus interest, the Commission is attempting to restore producers and customers to the position the parties would have been in if the Commission's present ruling was always in effect. This is in sharp contrast to the situation in *Panhandle* where the pipelines had a legal alternative to recover the section 110 costs, but did not use it because of the Commission's action.

The Commission has on occasion waived interest in individual cases where the petitioner demonstrated special hardship. Thus in *Robert H. White*, cited by producers, Mr. White sought a waiver of a refund of just over $3,300, including interest, that he contended was uncollectible from the owner of the royalty interest. The royalty owner—an elderly, disabled, insolvent woman facing bankruptcy—had assigned the royalty interest to her son to help compensate him for the care he had provided to her during her long illness. No such showing has been made in this request for generic adjustment relief since only general, possible hardships are alleged.

Estate of French, 603 F.2d 1158 (5th Cir. 1979), cited by producers, is also inapposite. In that case, in 1971 an Estate filed to relieve the Estate of a refund obligation concerning natural gas sales during the period 1959-1964. The proceeding in which the refund obligation arose commenced in 1963, but the Commission did not issue the order requiring refunds until eight years later in 1971. The Commission then did not act upon the Estate's 1971 adjustment request until 1978, when it denied the requested relief. The Court of Appeals upheld the Commission's denial of the request with respect to the principal. The court also denied the Estate's request for waiver of interest during the eight year period from 1963

until the 1971 issuance of the original refund order. However, the court did hold that the Commission's seven-year delay, from 1971 until 1978, in acting upon the request for relief from the refund requirement warranted waiving interest for that period. No such Commission delay in acting on a request for relief from a refund order has occurred here. Here, the relevant refund requirement was not finally established until May of this year when the Supreme Court refused to review the Court of Appeals' decision reversing our waiver of all refunds for the period 1983-1988, and no request for an adjustment was filed until the instant filings. The issue in this case is more comparable to the holding in *Estate of French* that interest should not be waived for the period prior to the Commission's 1971 refund order. Moreover, *Estate of French* did not involve a generic request for adjustment relief, but was based on a specific showing of hardship by a particular applicant for relief.

The Commission concludes that the court's decision in *Public Service* leaves the Commission little choice but to deny the Producers' request for an across-the-board waiver of interest on all the refunds required by the court. However, the Commission is not unmindful of the fact that this refund obligation, with interest included, could present a serious financial problem to specific producers, particularly small producers or producers who no longer have producing wells. The Commission will therefore entertain individual requests for adjustment relief under NGPA section 502(c) and subpart K of the Commission's procedural regulations.[24] Such requests should explain, as required by § 385.1104(a)(1)(iii), how denial of relief "will cause the applicant special hardship, inequity, or unfair distribution of burden." Accordingly, we will deny the Producers' petitions for adjustment, and will

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24 18 C.F.R. §§ 385.1101 *et seq.* (1997).

require First Sellers to refund principal and interest of the Kansas *ad valorem* tax overcharges from October 4, 1983,[25] without prejudice to individual producers filing for an adjustment under NGPA section 502(c) based upon their particular circumstances.[26]

The petitions for adjustment filed in Docket Nos. GP97-4-000 and GP97-5-000, seek relief on a generic basis, such as a complete waiver of interest for the 1983-1988 period, and a partial waiver of principal based on hardships if a full refund were required. We will deny the requests with respect to the waiver of interest since the petitioners seek that relief based upon the same arguments that we have rejected above.

To the extent that petitioners argue that a full refund of principal would cause a hardship, we will deny the generic request. The Small Producer Group suggests that for some members it will take up to 16 to 18 months of income from existing wells to recover the cost of the refunds required here. Other small producers might never

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[25] The *CIG* rehearing order clarified that the refund was applicable to any revenues collected in excess of the maximum lawful price based upon any "tax bill rendered after June 28, 1988," because the taxes are recovered only after the tax bill is rendered, 67 FERC ¶ 61,209 at p. 61,660 (1994). The same will be applicable here, except that we will change the date to October 4, 1983. We recognize that in *Public Service*, the court referred to "taxes collected with respect to production since October 1983," 91 F.3d at p. 1492, but believe that the clarification is applicable to the 1983 period as well.

[26] A number of intervenors filing in support of the Producers' petitions request that the Commission deem the intervention motion as their specific Petition for Adjustment under rule 1104, 18 C.F.R. § 385.1104. The instant proceedings involve generic issues that are applicable to all. Accordingly, we will not address these requests, and any party seeking relief must do so individually under subpart K of the Commission's Rules & Regulations, 18 C.F.R. § 385.1101 *et seq.*

be able to recover the amounts they must now refund, for example, because their wells are now depleted or abandoned. However, the Commission will not grant a generic waiver of refunds based upon such generalized allegations of hardship. Rather, the Commission may consider adjustment requests based upon a particular First Seller's situation on a case-by-case basis, pursuant to a specific filing under subpart K of our regulations.

The petitions also seek a limited waiver of principal in a variety of other situations. These situations are as follows:

> (1) where the royalty owner who was paid based on the assumption that the Kansas ad valorem tax was covered under NGPA section 110 cannot be located, the amounts are unrecoverable, or the amounts are *de minimis* and the cost of recovery would exceed the amount to be recovered; (2) where Kansas property taxes were paid based upon the Commission's prior determinations that the ad valorem tax was recoverable under NGPA section 110, and (3) where the ultimate consumer of the gas during the refund period cannot be determined or located.[27]

With respect to petitioners' arguments concerning waiver of refunds relating to the amount paid to royalty owners, we recognize that there may be situations where producers are unable to collect refunds attributable to royalty interest owners. The Commission will take the same approach to this issue as it took when the same issue arose with respect to Btu refunds.[28] Thus, the Com-

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[27] Mesa Petition at pp. 12-13. The Small Producer Group did not include item 2, but otherwise they make the same contentions.

[28] *See Refunds Resulting from Btu Measurement Adjustment*, Order No. 399-A, *FERC Statutes and Regulations*, Regulations Preambles [1982-1985] ¶ 30,612 at p. 31,217 (1985).

mission will consider waiver of a refund on grounds of uncollectability from royalty owners on a case-by-case basis, if a person seeking such relief can demonstrate that it attempted to collect the refund from the royalty owner and that the refund is uncollectible. The standard for determining whether a refund obligation is uncollectible from a royalty owner is set forth in *Wylee Petroleum Corp.*[29]

In *Ensign,* the producer argued that it should be permitted to waive the amount of refunds equal to the overpayment of property taxes because of the added value of the property from the add-on aspect of the *ad valorem* tax. In *Ensign* we denied the relief because the producer could have paid the tax under protest. We recognize that in *Ensign* we stated that the producer should not have relied on the Commission's prior ruling after the court's decision in *Colorado Interstate.* However, the court's discussion in *Public Service* would be applicable here as well, so producers should have filed any tax under protest once the petition was filed in 1983 questioning the continuing validity of the FPC's ruling on the Kansas tax.

In requesting waiver of refunds where the ultimate consumer of the gas during the refund period cannot be determined or located, the petitioners argue that "Where the pipeline's customers cannot be located, the pipeline should not be allowed to retain the refunds".[30] In short, their argument is premised on the assumption that, if the pipeline is unable to find a particular ultimate consumer that was overcharged, the pipeline would be able to retain that consumer's portion of the refund. This is clearly not what is intended. The pipelines will be required to pay over all refunds they receive to their customers. As set

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[29] 33 FERC ¶ 61,014 (1985).

[30] Mesa Petition at p. 15.

forth in appendix E to this order, pipelines will be required to make the refunds, to the maximum extent possible, to their customers who were actually overcharged, generally LDC's and other large end-users. The Commission recognizes that the pipelines will have to develop methods of estimating how much each customer was overcharged, and a few such customers may no longer exist. However, the Commission will require that pipelines flow-through all refunds in one way or another, without exception. Thus, petitioners' argument that the pipeline should not be permitted to keep the refund when "the overcharged customers" cannot be found is a situation which does not exist.

Finally, the Commission recognizes that implementation of this order may cause difficulties to some producers. The Commission encourages the pipelines and their customers to seek to work out these matters, in the first instance, with the producers. The Commission will be sympathetic to any arrangements that are entered into pursuant to such undertakings.

B. *The Refund Procedures*

In *CIG*, the Commission addressed the issue of the time frame for payment of the refunds by First Sellers, and how the refunds were to be flowed through, since the Purchased Gas Adjustment (PGA) mechanism, the mechanism for handling gas refunds, was no longer in place. The procedure adopted was "to ensure that *ad valorem* tax refunds will be made to customers who overpaid the pipelines and to avoid the problems of allocating these refunds to a pipeline's current customers." [31]

CIG required First Sellers to refund the overcharges, including interest, within 180 days after issuance of the

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[31] 65 FERC at p. 62,374.

Commission's final order. The pipeline receiving a refund was required to make refunds to the customers overcharged within 30 days after receipt of the refunds, after which interest would be due until payment was made. Pipelines were also required to file refund reports within 75 days after they paid the refunds.

Customers propose to modify these procedures by having a more expedited time table for the First Sellers' payment of refunds. Customers propose that the Commission require pipelines within 60 days of the Commission's order in this proceeding to bill First Sellers for the subject refunds by serving upon them a Statement of Refunds Due, and file these statements with the Commission. Additional interest will accrue on any unpaid amounts beginning 30 days after the pipeline's billing.

In support of their proposal, Customers contend that the additional delay that had occurred since *CIG* justifies the faster refund payment schedule. They assert that the first sellers and pipelines have been aware of their liability for the additional refunds since the *Public Service* decision in August 1996. Thus, Customers maintain that an expedited schedule for making refunds should pose no hardship on the first sellers or pipelines. Customers also note that requiring a Statement of Refunds due is actually what occurred following *CIG*, in that pipelines billed the first sellers for the refunds due. Thus, they maintain, the proposal formalizes this process both to expedite the refunds and to keep all affected parties apprised of the status of the refunds.[32]

First Sellers responding to Customers' petition generally oppose the modifications proposed. They urge that the

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[32] Customers also request the Commission provide for audit rights and dispute resolution procedures between pipelines and first sellers and between pipelines and their customers.

Commission to [sic] defer consideration of Customers' proposal until the Commission acts on the Producers' Request for Adjustments in Docket No. GP97-3-000. They also object to any faster refund schedule, arguing that the equities in fact require waiving of interest for the 1983-1988 period.

Pipelines and end-users, who would be the recipients of the refunds, generally support the Customers' proposal. However, a number of pipelines question the need for requiring the Statement of Refunds Due.

We believe there is merit in requiring the Statement of Refunds Due. The overcharges at issue relate to sales going back to 1983. Many First Sellers who unlawfully overcharged for the Kansas *ad valorem* taxes may not be aware of the *Public Service* decision, and also might not become aware of this order. Accordingly, it makes sense for the affected pipelines to notify the affected first sellers of their obligations to refund the unlawful overcharges, and the amount of the overcharges, including interest, that the pipeline believes is owing by such first seller. Pipelines must serve the Statement of Refunds Due on the affected first seller within 60 days after issuance of this order.

Payment of the refunds, with interest, will be due within 180 days after the date of this order. However, the Commission recognizes that making those refunds in a single lump-sum payment could be a substantial hardship for some producers, since in many cases the amount of the refund is likely to be substantial. Accordingly, first sellers may file a request, with appropriate supporting financial data, for permission to amortize their refunds over an extended period, not to exceed five years from the date of this order. Interest will continue to accrue on unpaid principal amounts until the date of payment.[33]

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33 Plains Petroleum Company and Plains Petroleum Operating Company (Plains) intervened in this proceeding, stating that they

Interstate pipelines must file a refund report within 250 days of the date of this order, showing the amounts they have received from producers (with principal and interest shown separately), and any producers who still owe refunds. Interstate pipelines shall file similar refund reports annually for the following five years. The flow-through of refunds by interstate pipelines will be the same as described in *CIG*.[34] Since the refund period now extends back to 1983, regulated gas sold to intrastate pipelines in excess of the MLP is also eligible for refunds. Accordingly, intrastate pipelines shall also file refund reports with the Commission and file a copy of the report with the State regulatory agency having jurisdiction over such pipelines.[35]

The Commission orders:

(A) The Petitions for Adjustment are denied as discussed in the body of this order.

(B) Within 60 days of issuance of this order, pipelines shall serve upon First Sellers a Statement of Refunds Due with respect to the Kansas *ad valorem* tax for the period

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had produced natural gas from various leases in Kansas during a time period relevant to this proceeding, and had recovered payment for the Kansas *ad valorem* taxes. Plains included no comments regarding Customers' proposal. Rather, Plains included a request for a summary ruling concerning the appropriate entity who should be liable for any refunds relevant to those sales. Plains' filing is not within the scope of this proceeding, and the filing has been redocketed as Docket No. GP97-6-000, and a separate notice has been issued with respect to that filing. Any response to Plains' filing in this proceeding will be considered in Docket No. GP97-6-000.

[34] The flowthrough procedures, essentially similar to the procedures in *CIG*, are described in detail in appendix E.

[35] The Commission required intrastate pipelines to file refund reports for the Btu refunds, *supra* n.28.

October 4, 1983 through June 28, 1988. The Statement shall include the amount, including interest, that the pipeline believes is owing by each first seller. The pipeline shall file with the Commission a copy of all such statements.

(C) Any First Seller that collected revenues in excess of the applicable maximum lawful price established by the NGPA as result of the reimbursement of the Kansas *ad valorem* taxes for sales based upon a tax bill rendered on or after October 4, 1983, shall refund in full any such excess revenues to the purchaser including interest calculated in accordance with §§ 154.102(c) and (d) of the Commission's regulations. The refunds are due within 180 days after issuance of this order. However, first sellers may file a request, with appropriate supporting financial data, for permission to amortize the refund payments over a period not to exceed five years.

(D) Interstate pipelines must follow the refund flow-through procedures set forth in *CIG*, and attached as appendix E to this order.

(E) Pipelines shall file refund reports with the Commission showing the amounts they received from producers (with principal and interest shown separately), and any producers who still owe refunds. The reports must be filed within 250 days of the date of this order and annually thereafter for the next five years.

(F) The refunds report must also describe the basis a pipeline used to apportion the refunds among its customers and be served on all of the pipeline's customers. Intrastate pipeline shall also file copies of the refund report with the State regulatory agency having jurisdiction over such pipeline.

APPENDIX A

Intervenors in Docket No. RP97-369-000

Amoco Production Company
Anadarko Petroleum Company
Atlantic Richfield company [sic]
Cabot Oil & Gas Corporation
Chevron U.S.A., Inc.
Colorado Interstate Gas Company
Conoco, Inc.
Consumers Energy Company
Dorchester Hugoton, Ltd.
Independent Petroleum Association of America *
Indicated Producers *
Kansas Small Producers *
State of Kansas and the Kansas Corporation Commission *
Kerr McGee Corporation
K N Interstate Gas Transmission Co.
Mesa Operating Corp.*
Michigan Gas Storage Company
Missouri Public Service Commission
Mobil Oil Corporation
Northern Natural Gas Company
OXY USA, Inc.
Panhandle Eastern Pipe Line Company
Plain Petroleum Company and Plains Petroleum Operating Company *
Texaco Natural Gas Co.
Undersigned Parties *
Union Resources Company
Vastar Resources, Inc.
Western Resources, Inc.
Williams Natural Gas Company

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* Protest

APPENDIX B

Intervenors in Docket No. GP97-3-000

ANR Pipeline Company
Atlantic Richfield Company
Cabot Oil & Gas Company
Chevron U.S.A., Inc.
Colorado Interstate Gas Company
Dorchester Hugoton, Ltd.
Independent Petroleum Association of America **
State of Kansas and the Kansas Corporation Commission
Kansas Small Producer
Kerr-McGee Corporation
K N Interstate Gas Transmission Co. **
Mesa Operating Co.
Missouri Public Service Commission *
Northern Natural Gas Company
Panhandle Eastern Pipe Line Company
Plains Petroleum Company and Plains Petroleum Operating Company
Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company *
Texaco Natural Gas, Inc.
Vastar Resources, Inc.
Western Resources, Inc.
Williams Natural Gas Company *

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* Protest

** Out-of-time

APPENDIX C

Intervenors in Docket No. GP97-4-000

Amoco Production Company
Anadarko Petroleum Corporation
ANR Pipeline Company
Atlantic Richfield Company
Cabot Oil & Gas Corporation
Chevron U.S.A., Inc.
Colorado Interstate Gas Company
Independent Petroleum Association of America **
Kansas Corporation Commission **
K N Interstate Gas Transmission Co.
Mobil Oil Corporation
Northern Natural Gas Company
OXY U.S.A., Inc.
Panhandle Eastern Pipe Line Company
Plains Petroleum Company and Plains Petroleum Operating company [sic]
Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company *
Texaco Natural Gas, Inc.
Union Pacific Resources Company
Vastar Resources, Inc.
Western Resources, Inc.*

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* Protest

** Out-of-time

APPENDIX D

Intervenors in Docket No. GP97-5-000

Amoco Production Company
Anadarko Petroleum Corporation
ANR Pipeline Company
Cabot Oil & Gas Corporation
Chevron U.S.A., Inc.
Colorado Interstate Gas Company
Independent Petroleum Association of America *
Kansas Corporation Commission *
K N Interstate Gas Transmission Co.
Mobil Oil Corporation
Northern Natural Gas Company
OXY U.S.A., Inc.
Panhandle Eastern Pipe Line Company
Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company **
Texaco Natural Gas, Inc.
Union Pacific Resources Company
Vastar Resources, Inc.

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* Out-of-time

** Protest

APPENDIX E

C. *Refund Procedures*

1. *Statement of Refunds Due*

Within 60 days of issuance of this order, pipelines shall serve upon First Sellers a Statement of Refunds Due with respect to the Kansas *ad valorem* tax for the period October 4, 1983, through June 28, 1988. The Statement shall include the amount, including interest, that the pipeline believes is owing by each first seller. The pipeline shall file with the Commission a copy of all such statements.

2. *Procedures for Refunds by First Sellers*

First Sellers who collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement on the Kansas ad valorem taxes for sales on or after October 4, 1983, shall refund any such excess revenues to the purchaser, including interest, in full. The refunds are due within 180 days after issuance of this order. However, each first seller may file a request, with appropriate supporting financial data, for permission to amortize the refunds over an extended period not to exceed five years.

3. *Procedures for the Flowthrough of Refunds by Pipelines*

Under the Natural Gas Act, the Commission has jurisdiction over the rates interstate pipelines charge their customers. We establish the following procedures for interstate pipelines to pass through any *ad valorem* tax refunds they receive from first sellers.

a. *Method of Flowthrough by Interstate Pipelines*

Due to the implementation of Order No. 636 [FERC Statutes and Regulations ¶ 30,939], interstate pipelines

have terminated their PGA elauses, which included a mechanism to pass through any refunds they received. Since this mechanism was used to reduce a pipeline's unrecovered purchased gas cost gas balance which would normally have been recovered from its customers over the next twelve-month period, this mechanism usually did not result in the flowthrough of refunds to customers in the same relative proportions of the actual overcharges because of changes in purchased gas patterns.

Since the PGAs have been terminated, *ad valorem* tax refunds can no longer be flowed through the PGA clause. In place of the PGA clause, pipelines implemented PGA close-out procedures. However, these close-out procedures may result in methodologies that are even more divergent from the proportionate sales ratios reflected in the PGAs. Therefore, to ensure that ad valorem tax refunds will be made to customers who overpaid the pipelines and to avoid the problems of allocating these refunds to a pipeline's current customers, the Commission will require interstate pipelines to make a lump-sum cash payment to the customers who were actually overcharged. We will require pipelines to make refunds to the customers actually overcharged within 30 days after receipt of refunds from the producers. If a pipeline does not make refunds within this 30-day period, the interest provisions in section 154.67(c) will be triggered and interest must be paid from the date of the pipeline receives the refunds from the producers until the date the pipeline pays refunds to its customers.

The Commission believes that a pipeline should: (1) allocate the refunds between jurisdictional and non-jurisdictional customers; and (2) allocate the total refunds due to the jurisdictional customers who were actually overcharged based on the proportion of each customer's purchases during the refund period compared to the total

jurisdictional sales during the refund period. Pipelines would then pay this refund to those customers in a lump-sum cash payment. In any event, pipelines are to process *ad valorem* tax refunds from other pipelines in the same manner as *ad valorem* tax refunds received from first sellers because this procedure will return such amounts to those customers actually overcharged.

Finally, the Commission notes that pipelines will not be required to be guarantors of refunds. However, the Commission urges interstate pipelines to actively pursue refunds owed by first sellers.

b. *Pipeline Refund Reports*

The Commission will require interstate and intrastate pipelines to file refund reports showing the amounts they received from producers (with principal and interest shown separately) and any producers who still owe refunds. The report must be filed 250 days after the date of this order and annually thereafter for the next five years.

The refund report filed by interstate pipelines must also describe the basis a pipeline used to apportion the refunds among its customers and be served on all of the pipeline's customers.

Intrastate pipelines shall also file copies of the refund report with the State regulatory agency having jurisdiction over such pipeline.

APPENDIX D

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 98-1227-98-1232, 98-1297 & 98-1298

ANADARKO PETROLEUM CORPORATION, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

AMOCO PRODUCTION COMPANY, *et al.*,
Intervenors.

Filed Jan. 21, 2000

ON PETITION FOR REHEARING

Before: EDWARDS, Chief Judge, SENTELLE and RANDOLPH, Circuit Judges.

Opinion for the Court filed PER CURIAM.

PER CURIAM:

Subsequent to our decision of October 29, 1999, the Commission petitioned for rehearing seeking clarification on the issue of the effective date for refunds discussed in Part V of our opinion. *See Anadarko Petroleum Corp. v.*

FERC, 196 F.3d 1264, 1269-70 (D.C.Cir.1999). Information presented to the Commission in other proceedings indicated that two of the factual assumptions upon which our opinion was premised were incorrect. First, contrary to this panel's understanding, *see id.* at 1270, the tax assessment sent to the producers by the State of Kansas between October and November of a given year was for the same calendar year and not the previous year. Second, the Commission discovered that producers most commonly sought reimbursement of the Kansas *ad valorem* tax from their customers in lump sum transactions and not by "raising their prices in individual transactions." *Id.* Thus, the Commission was uncertain how to give effect to the court's holding that "it is the overcharges made in those individual transactions (plus interest) that the producers must now repay." *Id.*

Whatever the nature of these transactions, the principle embodied in our decision remains unchanged. The Kansas tax should not have been subject to reimbursement for sales exceeding the maximum lawful price under § 110 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 320(a)(1) (1988) (repealed). However, the producers did not have notice that this practice was questionable until October 4, 1983. *See Anadarko*, 196 F.3d at 1266 (describing our earlier holding in *Public Service Co. of Colorado v. FERC*, 91 F.3d 1478, 1490 (D.C.Cir.1996)). If the producers collected tax reimbursemnts from their customers after that date, whether by lumpsum transactions or by any other means, they did so unlawfully and must refund the amounts collected with interest, provided that the tax reimbursements caused their sales to exceed the maximum lawful price. We leave to the Commission the unenviable task of applying this principle to the facts of ancient transactions.

* * *

The petition for rehearing is granted. The portions of our opinion of October 29, 1999, which are inconsistent with this opinion are withdrawn. The orders under review are vacated insofar as the question of refund dates is concerned and this issue is remanded to the Commission for further proceedings consistent with this clarification.

APPENDIX E

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 94-1418, 94-1481, 94-1489 and 95-1138

PUBLIC SERVICE COMPANY OF COLORADO, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

OXY USA INC., *et al.*,
Intervenors.

ON PETITIONS FOR REVIEW OF AN ORDER
OF THE FEDERAL ENERGY
REGULATORY COMMISSION

Argued Jan. 12, 1996

Decided Aug. 2, 1996

Before: WILLIAMS, GINSBURG and SENTELLE, Circuit Judges.

Opinion for the Court filed by Circuit Judge GINSBURG.

Concurring Opinion filed by Circuit Judge SENTELLE.

GINSBURG, Circuit Judge:

Until 1993 the Natural Gas Policy Act (NGPA) established the maximum lawful price that a producer could charge its pipeline customers for natural gas; under § 110 of the Act, the producer could adjust that price upward in order to recover its payment of a state severance tax. The Federal Energy Regulatory Commission, on remand from our decision in *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769 (1988), held that *ad valorem* taxes levied by Wyoming and Colorado are, but the *ad valorem* tax levied by Kansas is not, a severance tax within the meaning of § 110. The Commission then ordered producers to refund payments received from pipelines in recovery of the Kansas tax with respect to production occurring after the *Colorado Interstate* decision. The Commission directed the pipelines in turn to channel those refunds to their customers, but decided not to make the pipelines liable for any amounts not received from producers.

Petitioner Public Service Company of Colorado and a subsidiary (jointly PSCC), supported by the Missouri Public Service Commission (MPSC) as an intervenor, challenge the Commission's authority to limit the retroactivity of the producers' liability for refunds of the Kansas tax. As a petitioner the MPSC also objects to the Commission's order relieving Williams Natural Gas Company of any obligation to guarantee the refund of the Kansas taxes that Williams collected from its customers, as to which Williams intervenes in support of the FERC, and to the Commission's decision that the Wyoming and Colorado taxes are severance taxes.

Four producers petition for review of the Commission's decision that the Kansas tax is not a severance tax. These Producer Petitioners also maintain that the FERC's decision worked a change in the law that should be applied

prospectively only. As Producer Intervenors the same group argues in the alternative that the Commission properly limited their liability for the refunds of the Kansas tax to the date of the *Colorado Interstate* decision. Joined by another producer, the five so-called Indicated Producers intervene in support of the Commission regarding the Wyoming and Colorado taxes.

We conclude that the Commission could properly determine that the Kansas *ad valorem* tax was not, and that the Colorado and Wyoming *ad valorem* taxes were, sufficiently similar to a severance or production tax to qualify for recovery under § 110 of the NGPA. Contrary to the Commission, however, we hold that the producers must refunds all the Kansas taxes they collected since October 1983 when all interested parties were first put on notice that the taxes might not be recoverable under § 110. On the question whether Williams should be required to guarantee the refunds due from its producers to its customers, we find no ground upon which to require that the FERC hold the pipeline liable.

I. BACKGROUND

From 1978 until 1993 producer prices for natural gas were subject to maximum lawful levels specified in the NGPA. 15 U.S.C. §§ 3311-19. Section 110 of the NGPA permitted a producer to charge an amount in excess of those ceilings to the extent necessary to recover its payment of "State severance taxes attributable to the production of such natural gas," 15 U.S.C. § 3320(a)(1). For this purpose, a severance tax was defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natual gas" by a state or Indian tribe, 15 U.S.C. § 3320(c).

In *Sun Exploration and Production Co.*, 36 FERC ¶ 61,093 (1986), the Commission determined that the

Kansas *ad valorem* tax qualified as a severance tax under § 110 because it was based upon production factors. In *Colorado Interstate* we concluded that the Commission's analysis in *Sun Exploration* "fell short of reasoned decision-making," and we remanded the matter for a more "cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." 850 F.2d at 770, 773. Reflecting our indulgent standard of review for a question so bound up in administrative policy-making, we noted that while the court "cannot defer to a vacuum," we would defer to "any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable." *Id.* at 774.

We also offered the Commission some guidance. A severance tax is a cost imposed upon producing, while a property tax is a cost imposed upon holding, a resource; the non-recoverability of a severance tax is a disincentive to produce, while the non-recovery of a property tax is not a disincentive and, to the extent that extraction reduces the value of the reserves to which the property tax is applied, might even be an incentive to produce. *Id.* at 771. On the other hand, if in computing the value of a property for the purpose of levying a property tax "a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." *Id.* at 772.

Upon remand, the Commission identified two essential differences between a severance tax and a property tax:

> First, a . . . severance tax is *on* the volume or value of the commodity *removed*, as assessed at the time of removal. A property tax . . . is on the value of the gas remaining in the ground as well as on the value

> of wells and other production assets on the lease, at the time of the tax assessment.
>
> Second, . . . once the unit of gas is produced and the severance tax is applied to it, that unit of gas is never again subject to the severance tax. On the other hand, a property tax . . . is applied to a unit of gas reserves each year—year after year—until that unit of gas finally is produced and removed from the property being valued.

Colorado Interstate Gas Co., 65 FERC ¶ 61,292 at 62,370-71 (1993) (emphases in original) (hereinafter *Colorado Interstate Remand Order*), *reh'g denied*, 67 FERC ¶ 61,209 (1994) (hereinafter *Colorado Interstate Rehearing Order*). Applying these distinctions, the Commission concluded that the Kansas tax did not qualify as a severance tax for three principal reasons: (1) it was based upon the value of the gas property rather than upon its current production; (2) the volume of production was relevant principally for determining the present value of the gas reserves; and (3) the reserves were taxed year after year until removed from the ground and sold. *Id.* at 62,371-72.

The Commission ordered producers to refund the Kansas taxes they had collected since June 1988, the date of our *Colorado Interstate* decision which, in the FERC's view, first put producers on notice that the tax might not be recoverable under § 110. *Id.* at 62,373. The Commission also ordered pipelines to flow-through the refunds to customers as lump sum payments, but the pipelines were not held responsible for guaranteeing payment if a producer failed to meet its refund obligation. *Id.* at 62,374.

Williams, one of the pipelines ordered to refund the Kansas tax, had also collected Wyoming and Colorado

ad valorem taxes from its customers. In *Williams Natural Gas Co.*, 69 FERC ¶ 61,373 (hereinafter *Williams Order*), *reh'g denied*, 70 FERC ¶ 61,202 (1994) (hereinafter *Williams Rehearing Order*), the Commission held that the Wyoming and Colorado taxes qualified as severance taxes under § 110. The Wyoming tax "is assessed on the volume or value of the gas which is produced" and "varies directly, and exclusively, with actual production." *Id.* at 62,408. The Colorado tax is "assessed only against gas that is severed from the ground." *Id.* at 62,410. Therefore, Williams was not required to refund these taxes to its customers.

II. ANALYSIS

We turn first to the question whether the Commission was reasonable in holding that the Kansas tax was not recoverable under § 110. Next we undertake a similar inquiry with respect to the Colorado and Wyoming taxes. Then we examine the date to which refund liability for the Kansas tax extends; and finally we review the FERC's decision not to hold Williams responsible as a guarantor in the event that a producer does not meet its refund obligation.

A. The Kansas Tax

Our review of the Commission's interpretation of § 110 of the NGPA is governed by the familiar analysis of *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984): if the Congress has "directly spoken to the precise question at issue," the court "must give effect to the unambiguously expressed intent of Congress"; otherwise the court will defer to the administering agency's interpretation if it is reasonable in light of the structure and purpose of the statute. *Id.* at 842-43, 104 S.Ct. at 2781-82. In this instance, recall that § 110 of the NGPA

permits a producer to "recover . . . State severance taxes attributable to the production of . . . natural gas and borne by the seller," 15 U.S.C. § 3320(a)(1), and that a severance tax is defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." 15 U.S.C. § 3320(c). In their application to a particular state tax, any or all of the terms "attributable to the production," "similar," "other levy," and "imposed on the production" may be ambiguous. Plainly, as the Producer Petitioners acknowledge, our standard of review is that of *Chevron* step two.

The Kansas tax is levied primarly upon the value of recoverable reserves and secondarily upon the value of gas well equipment and materials. In estimating the volume of reserves, the volume of current production is an important factor; therefore, because the tax is partly dependent upon production, the Producer Petitioners allege that it is similar to a production tax.

In remanding *Colorado Interstate* we instructed the Commission to come up with a "cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." 850 F.2d at 773. The agency's determination was to hinge upon "how the specific rules of the tax actually function." *Id.* at 774. According to the Producer Petitioners, however, the Commission responded largely by ignoring the practical application of the Kansas tax and its actual effect upon production incentives, and focused instead upon mere labels.

The principle advanced by the Producer Petitioners is that "a tax whose assessment is measurably affected by a change in the level of production is at least in part attributable to, and effectively imposed on, the production itself." The Petitioners remind us that the Federal Power Commission held that the Kansas tax was recoverable under the Natural Gas Act, Opinion No. 699-D, 52 FPC 915,

915-16 (1974), and that the Congress incorporated into § 110 of the NGPA terms virtually identical to those it had used in the prior statute, *see* Opinion No. 699, 51 FPC 2212, 2301, 4 P.U.R.4th 401, *reh'g denied in relevant part*, 52 FPC 1604 (1974), *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir.1975)—which suggests that the Congress intended no significant contraction in the range of severance taxes that could be recovered. Indeed, the Conference Committee Report on § 110 states that the term "severance tax" should be "construed broadly" and may extend to "any tax imposed upon mineral or natural resource production including an ad valorem tax or a gross receipts tax." H.R. CONF. REP. No. 95-1752, 95th Cong., 2d Sess. 91 (1978), U.S. Code Cong. & Admin.News 1978, pp. 8800, 8861.

The two characteristics of a tax recoverable under § 110, in the view of the Producer Petitioners, are that its calculation is directly related to the rate of current production and that its non-recovery would operate as a disincentive to produce. It is not necessary that the tax be attributable exclusively to production, nor that it be computed in the same manner as a severance or production tax; it is enough that the assessed liability be to some extent "attributable to the production of . . . natural gas." The Producer Petitioners claim that the FERC's interpretation—under which the tax must be (1) laid upon "the act of severing," (2) "each Mcf or MMBtu of gas production," and (3) assessed "at the time of removal," *Colorado Interstate Remand Order*, 65 FERC at 62,370, 62,371—effectively reads the term "similar tax" out of the statute.

Applying their more liberal construction of § 110, the Producer Petitioners contend that the Kansas tax fully satisfies the criteria for recoverability. First, while the tax is also affected by variables other than production, the

amount of the tax increases or decreases as production increases or decreases. For example, as between two wells with the same reserves, the one expected to produce more gas will be taxed at a higher level. This argument, however, does little to dispel our understanding that the Kansas tax is by its terms a tax upon property. The value of a depletable asset is a function of its physical and its temporal dimensions; in the case of a gas well, these are respectively the volume of recoverable reserves and the timing of their recovery, which progressively depletes the reserve. The greater the volume of gas produced in given tax year, the shorter the time over which all the proceeds will be realized and, consequently, the higher the present value of the asset.

The relevant question, therefore, is the obverse of the one suggested by the Producer Petitioners. We do not ask whether two wells with the same reserves would be taxed differently based upon their different anticipated rates of production; obviously they would be, whether the tax is imposed *ad valorem* upon property or upon production. The value of the reserves would be higher for the well with more rapid production because faster production reduces the time over which the flow of gas is turned into a stream of cash. Instead, we must inquire whether the same tax would be levied upon two wells with different reserves but the same level of production. If the tax is based upon production, then the amount of the tax would be the same; if the tax is based upon property, then the amounts would be different. By this criterion, as we shall see, the Kansas tax is laid upon property, not upon production.

In *Colorado Interstate* we posited that the high initial level of production caused by the pressure in a new well could, when annualized in accordance with Kansas's method of appraisal, yield a higher tax upon a property

that started operation late in the year than upon an equally productive property that was in operation for the full year. 850 F.2d at 773. Prompted by that observation, the Producer Petitioners now attempt to explain that the State's use of an annualized figure for production when a new well operates for only part of its first tax year does not relax the relationship between the amount of the Kansas tax and the volume of production. To the contrary, they point out that a 1980 amendment to the Kansas tax law was designed to offset the disproportionately high levy on a well in operation less than six months during the tax year by reducing its appraised value by 40 percent.

Again, the Producer Petitioners' argument supports not their position but the Commission's. As the agency properly observes, an adjustment for the exaggerated level of initial production caused by the high pressure in a new well would be unnecessary if the Kansas tax were indeed based upon production. Any gas produced would be taxed; any gas left in the ground would not be taxed. Kansas authorized an adjustment precisely because its tax is based not upon production but upon gas in the ground; *i.e.*, the State needed a reliable estimate of "annual production to use in calculating the present value of recoverable reserves. Otherwise there would have been no need to annualize the partial year's output from a new well.

The Commission gave three reasons for rejecting the "measurably attributable to production" standard suggested by the Petitioners. First, it is just the type of murky standard that this court had criticized in *Colorado Interstate. Colorado Interstate Rehearing Order*, 67 FERC at 61,654. Second, the standard is cumbersome to administer; it requires "virtually well-by-well analysis to ascertain exactly how much weight the state property appraiser gave to current production." *Id.* at 61,654-55. Third, simply providing that a tax be measurably related

to production does not distinguish between a severance tax and an array of other taxes—income, personal property, real estate—that could vary "in a more-or-less direct manner with production." *Id.*

What is required, contends the Commission, is that the tax vary "directly" with production on "essentially" a one-to-one basis. *Colorado Interstate Rehearing Order*, 67 FERC at 61,655. Indeed there is some support for that proposition in the history of § 110. In 1974 the Federal Power Commission interpreted the Natural Gas Act to allow recovery of the Kansas tax. Opinion No. 699-D, 52 FPC at 915-16. As we observed in *Colorado Interstate*, however, when the Congress enacted § 110 it supplemented the FPC's formula for recovery ("all . . . production, severance, or similar taxes," Opinion No. 699, 51 FPC at 2301) with the added requirement that the tax be "imposed on the production of natural gas." 850 F.2d at 772. That new qualification is the basis upon which the Commission argues for a one-to-one relationship between the volume of production and the amount of the tax.

The Kansas tax, according to the FERC, is a property tax levied upon the value of recoverable reserves, gas well equipment, and materials, *id.* at 62,374; current production is only a "yardstick by which the value of the leasehold is measured," *id.* at 62,371-72. The appraised value of the reserves depends upon the estimated future production of the well (as determined in part by actual production over the most recent three- or five-year period) and market prices, reduced by operating costs, all forecasted over the probable period of production and discounted to present value. *See Colorado Interstate*, 850 F.2d at 771. Because of differences in the anticipated rate of production and in the estimated quantity of reserves, the tax

upon two wells producing the same volume of gas may "vary nearly by a factor of ten." *Id.*

At oral argument, we asked counsel for the Producer Petitioners whether in practice the tax on a well varies over time in direct relation to the well's production. If not, the tax could not properly be characterized as being based upon production. Because the answer to this question has important implications, we take a moment to examine the mechanics of the tax calculation in somewhat greater detail.

The value of recoverable reserves, for the purpose of the Kansas tax, is based predominantly upon the value of the well's average production multiplied by a "present worth factor." The present worth factor, in turn, depends upon the estimated quantity of the reserves, the time value of money, the expected rate of change in the price of gas, and the expected rate of change in production. The Kansas Department of Revenue promulgates a present worth factor for use in valuing all properties in a major proven gas field. Assuming that the Department determines present worth factors *ex ante* and does not revise them periodically, then the only variable affecting the annual appraisal of a well is the value of the well's production. Under these circumstances, the Kansas tax would, in our view, be sufficiently like a tax "imposed on the production of natural gas" to be recoverable under § 110. Although the tax is called an *ad valorem* tax and calculation of the tax is based upon the present value of recoverable reserves, any change in the amount of the tax due would depend in practice entirely upon a change in the value of production from year-to-year.

The question, therefore, becomes whether there is a change over time in the present worth factor for a particular well or field. If so, then the tax will depend upon

the magnitude of that change (and upon any variation in production, of course). In fact, because increased production diminishes the remaining recoverable reserves, and thus typically reduces the anticipated life of a well, periodically updating the present worth factor could yield a tax that is completely unrelated to, or even negatively correlated with, production. Counsel for the Producer Petitioners was not able to refer us to any evidence in the record indicating that the present worth factor for a single field remains constant over time. Therefore, the Petitioners could not show that the Kansas tax necessarily varied in direct relation to production.

Because the Producer Petitioners bear the burden of showing that the Commission's analysis of the Kansas tax is unreasonable, their inability to demonstrate that the present worth factors are invariant over time could have been an end to the matter. Nonetheless, we searched the record independently—but the result was only to increase our confidence that variables other than production can have a material impact upon the tax assessed. Tables captioned "Major Proven Gas Areas and Fields" show a substantial change in the present worth factor for certain fields over the three years from 1986 to 1989. Indeed, the prevailing pattern is for the present worth factor to decline with the passage of time, which is what we would expect. As the anticipated life of a well declines, the present value of the recoverable reserves decreases correspondingly; that is consistent with our hypothesis that higher production foreshadows a diminished remaining life, which in turn can result in not a higher but a lower tax.

There is more. One appraiser for the Kansas Department of Revenue has identified seven factors other than current production that he considers in determining the present value of reserves: age of the well; quality of the

oil and gas; nearness to market; operating costs; character, extent, and permanency of the market; probable life of the well; and the number of other wells being operated. Furthermore, Kansas assesses the tax upon each physical unit of reserves, year after year until the unit is produced. In order to qualify as a severance or production tax under § 110, however, a physical unit must be taxed only once—at the time of production. *Colorado Interstate Remand Order*, 65 FERC at 62,371. The Commission also observes that a typical well in the Permian Basin, roughly 2800 feet deep, will be appraised at a value that includes $56,000 for equipment alone, *i.e.*, exclusive of the value of any gas reserves. Even after a well has been shut-in for two years the equipment on a "normal" well is valued at $4,200. If the Kansas tax were based upon production, then there would be no tax on a non-producing well.

Singly and cumulatively, the Commission's arguments are convincing and neither of the Produced Petitioners' two principal contentions persuade us otherwise. First, the Producer Petitioners contend, mistakenly, that non-recovery of a property tax based in part upon production operates as a disincentive to produce and thus defeats a primary objective of the NGPA. If the present value of reserves is computed by the Kansas formula, then (other things being equal) the higher the tax rate the greater the incentive to produce. Although higher production is a factor tending to increase the Kansas tax this year, it reduces the expected future production from the well, a factor tending to decrease the Kansas tax in all future years. The tax-reducing effect of decreased life expectancy will almost always exceed the tax-increasing effect of higher production.[1] In short, if demand is inelastic (as

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[1] Suppose, for example, a well with 1,000 Mcf of reserves at year end 1995 is taxed at the rate of $1 per Mcf remaining on December

it would be when the ceiling is well below market price), a recoverable tax would have little effect upon production at the margin; but a non-recoverable tax would be an incentive to extract gas more rapidly in order to minimize the impact of the tax.

Second, the Petitioners advance the theory (in their Reply Brief) that "a tax qualifies for reimbursement under § 110 . . . if production is a factor in the calculation." By that standard, an ordinary property tax would qualify as a tax on production; the value of any asset is, after all, the present worth of the benefits that the asset is expected to produce—whether impounded in an established market price or estimated by an appraiser. The Commission reasonably declined to adopt a standard —overbroad, administratively cumbersome, and almost infinitely elastic—with so little to recommend it.

Weighing the various arguments—and mindful that as we said in *Colorado Interstate*, "any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable, will control," 850 F.2d at 774—we conclude that the FERC's interpretation of § 110 of the NGPA is reasonable. Furthermore, applying that interpretation, the Commission reasonably determined that the Kansas *ad valorem* tax is not a severence tax within the meaning of that section.

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31 of each year. The producer would have an incentive to deplete the well as quickly as possible. Production of 500 Mcf on January 1 of both 1996 and 1997 would mean tax assessments of $1,000 and $500 on December 31 of 1995 and 1996 respectively. By comparison, production of 250 Mcf on January 1 of each year from 1996 through 1999 would mean tax assessments of $1,000, $750, $500, and $250 on December 31 of each year from 1995 through 1998—and a much higher total tax. (This assumes of course that the estimated volume of reserves does not change from year to year except to account for the previous year's production.)

B. *The Colorado and Wyoming Taxes* [2]

The MPSC, while agreeing with the Commission's interpretation of § 110, urges that the FERC incorrectly applied its own criteria when it allowed recovery of the Colorado and Wyoming taxes. In the *Williams Order*, the Commission stated that "the Wyoming *ad valorem* tax qualifies for recovery . . . in that it is assessed on the volume or the value of the gas which is produced rather than upon the value of gas reserves or lease-hold property. Hence, the tax varies directly, and exclusively, with actual production." 69 FERC at 62,408. The Commission adopted the same rationale in deciding that the Colorado tax could be recovered under § 110. *Id.* at 62,410. The MPSC asserts that this rationale conflates a production-based tax with a property tax.

According to the MPSC, the Wyoming and Colorado taxes are based upon proceeds, not upon production. Taxing authorities administer a proceeds tax as they do a property tax: the underlying property is placed on both state and local tax rolls and aggregated with other property to determine the appropriate state and local *ad valorem* tax rates. A production tax, by contrast, is a

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[2] The Indicated Producers claim that the MPSC is barred from contesting the Colorado and Wyoming taxes because the MPSC was some hours late in filing its request for rehearing the *Williams Order*. The FERC, however, waived the 30-day limit in the NGPA, 15 U.S.C. § 3416(a)(2), and accepted the MPSC request as timely filed, *Williams Rehearing Order*, 70 FERC at 61,633. The Indicated Producers argue that the FERC had until then consistently treated the 30-day limit as a jurisdictional requirement that it could not waive. The MPSC replies that the Indicated Producers failed to request rehearing of the Commisssion's decision to waive the time limit, and thereby failed to preserve the issue for judicial review. We agree. *See* 15 U.S.C. § 3416(a)(4) (no judicial review unless issue raised before agency in application for rehearing). We proceed therefore to address the question whether the Colorado and Wyoming taxes were recoverable under § 110.

state-wide levy subject to a single state-wide rate, administered by and for the benefit of the state and not of the locality. The MPSC contends that the Wyoming and Colorado taxes differ from a typical property tax only in that they grant a preference to natural gas property over other types of property. In Wyoming, the preference arises by taxing gas property only once, which is to say when the gas is extracted. In Colorado, gas reserves are taxed annually but their value is assumed to equal a specified percentage of the value of the prior year's production. Otherwise, according to the MPSC, the Wyoming, Colorado, and Kansas taxes are similar and ought to be treated similarly under § 110; the Wyoming and Colorado legislatures may be free to favor gas producers over other property owners, but the Congress did not intend to favor gas producers in states with a tax based upon proceeds over gas producers in states that impose upon them a traditional property tax.

The Commission responds, first, that the Wyoming *ad valorem* tax meets the criteria set forth in the *Colorado Interstate Remand Order* and applied in the *Williams Order*, 69 FERC at 62,408. The tax is assessed upon the volume of gas removed from the well, Wyo. Stats. § 39-2-208; payable "one time only . . . as a result of production," *Union Pac. Resources Co. v. State*, 839 P.2d 356, 372 (Wyo.1992); and based upon the "full value" of the gas when produced, *id.* at 372 n. 7. Second, that the tax may benefit local taxing units is not pertinent; a tax imposed "by any political subdivision of a State" is recoverable under § 110. 15 U.S.C. § 3320 (c)(2). Third, as this court has recognized, "a tax nominally on property may be functionally identical to a production tax," *Colorado Interstate*, 850 F.2d at 772. Fourth, a tax need not be labeled a "severance tax" in order to be "recoverable" within the meaning of § 110;

the term "severance tax" is to be "construed broadly," and may include an *ad valorem* tax, H.R. CONF. REP. No. 95-1752 at 91, U.S.Code Cong. & Admin.News 1978 at 8861, as well as any "similar tax, fee, or other levy imposed on the production of natural gas," 15 U.S.C. 3320(c).

Finally, the Commission argues that administrative differences between a tax based upon production and an *ad valorem* tax are irrelevant to the question whether the tax may be recovered under § 110. Indeed, Wyoming has a separate severance tax, which no one here doubts is recoverable within the meaning of § 110. In distinguishing that tax from the state's *ad valorem* tax based upon proceeds, the Wyoming Supreme Court observed: "[T]he severance tax is an excise tax upon the current and continuing privilege of extracting minerals. . . . An ad valorem tax is a property tax which taxes the value of the minerals produced." *Wyoming State Tax Comm'n v. BHP Petroleum Co., Inc.*, 856 P.2d 428, 434 (1993). This characterization of the Wyoming *ad valorem* tax supports the Commission's conclusion that it is based upon production.

Colorado, too, imposes a severance tax in addition to an *ad valorem* tax. The Indicated Producers point out, however, that 87.5% of the *ad valorem* tax may be taken as a credit against the severance tax. This, say the Indicated Producers, proves that the two taxes are "directed at the same activity and intended to accomplish the same purpose, *i.e.*, to tax production as it occurs." Moreover, as the Tenth Circuit noted—albeit in the course of determining whether the Colorado tax is a real estate or a personal property tax, not whether it is sufficiently similar to either a severance or other production-related tax to be recovered under § 110—"[p]ast production is used

in the Colorado ad valorem tax system only as a gauge for the valuation of the mineral interest. Use of this admittedly imperfect gauge does not rule out the conclusion that the mineral interest itself is being taxed." *Federal Land Bank of Wichita v. Board of County Comm'rs*, 788 F.2d 1440, 1442 (1986).

The Commission nonetheless argues persuasively that the Colorado *ad valorem* tax "varies directly with production" and is "assesed only against gas that is severed from the ground." *Williams Order*, 69 FERC at 62,410. The irreducible fact is that the tax is computed as a set percentage of the market value of the gas removed from a well during the tax year. Colo.Rev.Stat. §§ 39-7-101 and 39-7-102. As we stated in *Colorado Interstate*: When computing the value of property, "[i]f a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." 850 F.2d at 772. That is precisely how the Colorado tax is computed.

In sum, the clear weight of the arguments supports the Commission's determination. Both the Colorado and Wyoming *ad valorem* taxes are based upon production and as such may be recovered under § 110 of the NGPA.

C. Retroactivity

Next we take up the question whether the Commission properly ordered producers to refund Kansas taxes recovered since, and only since, our *Colorado Interstate* decision in June 1988. The governing principle is that when there is a "substitution of new law for old law that was reasonably clear," the new rule may justifiably be given prospectively-only effect in order to "protect the settled

expectations of those who had relied on the preexisting rule." *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1554 (D.C.Cir. 1993). By contrast, retroactive effect is appropriate for "new applications of [existing] law, clarifications, and additions." *Id.* The Commission concluded that "[t]he 'settled expectations of those who had relied on the preexisting rule' . . . were changed by the [court's June 1988] *Colorado Interstate* decision, not really [by the FERC's] own decision" in the 1993 *Colorado Interstate Remand Order*, 65 FERC at 62,373.

The Producer Petitioners maintain that the Commission did indeed substitute a new rule for a reasonably clear old rule when, in the *Remand Order*, it first refused to let them recover the Kansas tax. Our decision in *Colorado Interstate*, the Petitioners point out, was a remand, not a reversal, of the Commission's decision in *Sun Exploration* allowing producers to recover the tax. The court directed the Commission only "to exercise its interpretive authority, to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently.' 850 F.2d at 775. We did not indicate that we expected a particular result, and consequently we did not disturb the settled expectations of producers who were relying upon the old rule. Upon this view of the matter, it was precisely the Commission's ruling in the *Remand Order* that did change the governing law; prior to that decision, the Petitioners contend, they did not have reason to anticipate that the Commission would change the rule. As they point out, that the agency had not previously engaged in reasoned decisionmaking did not mean that it could not reasonably reach the same result upon remand. Accordingly, the Producer Petitioners argue that their refund liability should extend back not to June 1988 but only to December 1993.

PSCC, on the other hand, argues that regardless of when the Commission first determined that recovery of the Kansas tax was unlawful, it necessarily had been unlawful since the NGPA was enacted in 1978. After first arguing before the Commission for full retroactivity back in 1978, however, PSCC conceded that "fundamental fairness . . . [dictates] that the date on which interested parties were put on notice of the dispute should control the date of retroactivity." Request-for [sic] Rehearing, *Colorado Interstate Gas Co.*, Dkt. Nos. GP83-11-003 and RI83-9-004, at 6 (FERC Jan. 3, 1994). Therefore, suggested PSCC, liability for refunds should extend back at most to August 1983, when Northern Natural petitioned the Commission for a determination that the Kansas tax was not recoverable under § 110, or at least to October 1983, when all interested parties received notice of the petition by publication in the Federal Register. *Id.* at 4.[3] As between the two, the later date is obviously the correct one. *See Associated Gas Distribs. v. FERC*, 899 F.2d 1250, 1256 (D.C. Cir.1990) (FERC gives notice of petition by publication in Federal Register).

To recapitulate, the various parties now urge that when the Commission issued its *Colorado Interstate Remand Order* in December 1983, it should have made liability for refunds (per the Producer Petitioners) prospective-only; (per the Commission) retroactive to June 1988, when we issued our decision in *Colorado Interstate*; or (per PSCC) retroactive to October 1983, when notice of

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[3] The MPSC argues for full retroactivity back to 1978, but we agree with the Producer Intervenors that it is precluded from raising that argument before us. The MPSC did not make a retroactivity argument in its request for rehearing before the FERC, and it does so here only as an intervenor, not as a petitioner. *See Illinois Bell Tel. Co. v. FCC*, 911 F.2d 776, 786 (D.C.Cir. 1990) ("An intervening party may join issue only on a matter that has been brought before the court by another party").

Northern Natural's petiton to disallow recovery of the Kansas tax was published in the Federal Register.

PSCC, the MPSC, and the Commission all argue against prospective-only application. By December 1993 gas at the wellhead was no longer subject to a maximum lawful price; deregulation had rendered § 110 moot almost a year before. *See* Natural Gas Wellhead Decontrol Act of 1989, Pub.L. No. 101-60, 103 Stat. 157. Accordingly, producers would have no liability under a rule that limited refunds to taxes paid on post-December 1993 production. Their point seems to be that customers should not lose their entitlement to refunds merely because the Commission took five years after our decision in *Colorado Interstate* to issue the *Remand Order.*

The FERC makes a more convincing argument against prospective-only application of its 1993 decision based upon this court's criticism in *Colorado Interstate* of both the logical and the factual bases for the agency's prior policy; that sent a "clear signal" to producers that their recovery of the Kasas tax under § 110 might not be lawful. After that "the parties no longer would have been justified in relying on the Commission's earlier rulings with any assurance that they would not later be required to make refunds." *Colorado Interstate Remand Order,* 65 FERC at 62,373.

The Commission marshals the events leading up to the *Colorado Interstate* remand in further support of this compromise view. As we have seen, under the Natural Gas Act, the Federal Power Commission had held in 1974 that the Kansas tax could be added to the maximum lawful rate. Opinion No. 699-D, 52 FPC at 915-16. Four year later the Congress carried forward into the new NGPA a provision nearly identical to the provision of the NGA that the FPC had earlier applied to the Kansas tax. *See* Opinion No. 699, 51 FPC at 2301. Furthermore,

in the legislative history of the NGPA the Congress specifically anticipated that producers might recover an *ad valorem* tax under § 110. H.R. CONF. REP. No. 95-1752 at 91, U.S.Code Cong. & Admin.News 1978, at p. 8861. In 1986 the Commission reaffirmed that the Kansas tax was recoverable under that section. *See Sun Exploration*, 36 FERC ¶ 61,093. Not until our 1988 decision in *Colorado Interstate*, remanding *Sun Exploration*, was there any official suggestion that the law might be otherwise. Finally, in 1993 the Commission effectuated a change in the law by developing new standards for determining whether a tax may be recovered under § 110. Thus, according to the Commission, the producers had no indication that the rule might be any different until our *Colorado Interstate* decision in 1988, and requiring them to refund taxes recovered with respect to gas produced prior to that date is not justified.

The agency also concludes that requiring refunds back to the date of our decision in June 1988 properly balances the produers' equitable claim to notice against the consumers' legal right to receive a refund of all unlawfully collected charges. On the one hand, prospective-only application of the law would permit producers to retain sums collected from June 1988 to December 1993 in excess of the maximum lawful prices prescribed in the NGPA—without any supporting rationale. On the other hand, a fully retroactive remedy would penalize producers by requiring disgorgement of sums they innocently collected prior to June 1988—even though our 1988 *Colorado Interstate* decision was the first authoritative indication that the Kansas tax might not be recoverable after all.

In support of making the Commission's decision retroactive to 1983, PSCC offers a different account, or at least one with a different emphasis, of the transition from the NGA to the NGPA. In this version the key point is

that the Commission does not have the expansive remedial powers under the NGPA that it wielded under the NGA, 15 U.S.C. § 717c(e). Specifically, whereas the NGA gave the Commission discretion to order refunds if it determined that a rate was not just and reasonable, the NGPA established maximum lawful prices and gave the customer a right to a refund if it was overcharged.

PSCC also points out that when it issued the *Remand Order* the Commission was not engaged in rulemaking but in adjudicating the rights of the parties before it; therefore the agency was necessarily articulating and giving retroactive effect to existing law. When it is clarifying existing law, rather than substituting new law for old, the agency need not be as attentive "to protect[ing] the settled expectations of those who had relied on the preexisting rule." *Williams*, 3 F.3d at 1554. Indeed, as PSCC points out, the producers never explain how their "settled expectations" led them into detrimental reliance upon being able to recover the Kansas tax.

As we see the issue, the apparent lack of detrimental reliance on the part of the producers is the crucial point. What would they have done differently if they had known in 1983 that they were not entitled to recover the Kansas tax? They could not have raised their prices above the maximum lawful level regardless whether the traffic would have borne such an increase. Nor do they contend that existing prices were below the lawful limit; and if they were, price increases might still have been foreclosed by competitive constraints. The producers may have shut in some wells or refrained from exploring for new wells if their inability to recover the tax would have rendered the wells unprofitable, but neither the producers nor the Commission has even suggested these possibilities. All the producers do suggest is that "[a] prudent producer would have cut back on production to the extent that non-

recovery of the tax increased [the] current marginal cost of production," Petition of Producer Petitioners for Rehearing of Order on Court Remand, *Colorado Interstate Gas Co.*, Dkt. Nos. GP83-11-003 and RI83-9-004, at 23 (FERC Jan. 3, 1994), but in this they are mistaken; as noted above, the more slowly a well is depleted, the greater the remaining reserves and the higher the tax thereon. Moreover, neither party has even roughly quantified the harm (*e.g.*, the expenditures made and lost in detrimental reliance upon being able to recover the Kansas tax) that the producers might suffer should they have to refund the full amount that they unlawfully collected. In these circumstances, we are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recovery of the tax (assuming any party were seeking such extensive relief).

Not only is the producers' "detrimental reliance" purely notional; if it were real it would not have been reasonable. The enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax under the NGA would withstand scrutiny under the NGPA; reliance would have been foolhardy. If that were not enough, the status of the Kansas tax was expressly drawn into question in 1983 when Northern Natural first petitioned the Commission for a ruling that producers could not lawfully recover the tax under § 110. Once the recoverability of the tax was in dispute, we do not see how the Commission could possibly find that producers reasonably relied upon continuing to recover it.

Because no seller of natural gas could justifiably be confident that it was entitled to recover the tax until the legal question was settled anew under the new statute, we hold that the producers' liability for refunds extends

back to October 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 110 of the NGPA was at issue, and the earliest date advocated by any party before this court. Absent detrimental and reasonable reliance, anything short of full retroactivity (*i.e.*, to 1978) allows the producers to keep some unlawful overcharges without any justification at all. The court strongly resists the Commission's implication that the Congress intended to grant the agency the discretion to allow so capricious a thing. Still, we do not require refunds of taxes recovered with respect to production before October 1983 because there is before us no controversy over those monies.

D. The Pipeline as Guarantor

In the *Colorado Interstate Remand Order* the Commission required interstate pipelines to "pass through any *ad valorem* tax refunds they receive from first sellers," 65 FERC at 62,374, but made it clear that "pipelines will not be required to be guarantors of refunds." *Id.* The MPSC, on behalf of the customers of the Williams pipeline, was the only party to challenge that decision. The FERC adhered to its position, however, adding that Williams should not be treated differently than other similarly situated pipelines. *Williams Natural Gas Co.*, Dkt. Nos. TA89-1-43-004 and RP89-39-005, slip op. at 5 (FERC order June 2, 1994), *clarification denied, Williams Order*, 69 FERC ¶ 61,373. The MPSC properly dispatches the FERC's afterthought with the obesrvation that it is routine for one pipeline to be required to make refunds while others are not—because the one is challenged and the others are not.

In its petition or review, the MPSC raises three objectons to this aspect of the Commission's decision. First, it observes that under § 4 of the NGA the Commission is

authorized to order refunds of any amounts collected from consumers in excess of what is just and reasonable. 15 U.S.C. § 717. Second, the MPSC contends that until the *Colorado Interstate Remand Order* was issued in December 1993, Williams should have understood that when it was allowed to continue collecting from its customers the amount of the Kansas tax "subject to refund," it became conditionally obligated to refund any amount later determined to be unlawful. Indeed, Williams received explicit notice in 1989 that the Commission was considering whether monies collected in recovery of the Kansas tax would have to be refunded. *Williams Natural Gas Co.*, 47 FERC ¶ 61,114 at 61,341. According to the MPSC, this notice should have prompted Williams to take reasonable steps to assure that it could in turn obtain refunds from its suppliers. Third, the MPSC asserts that the Commission should have required Williams to put the monies it received for the Kansas tax into escrow (or post a bond or obtain a letter of credit) in order to assure their return if need be. Escrow arrangements are commonly used when a rate increase is conditionally allowed to take effect until the agency determines whether it is lawful. *See, e.g., Transcontinental Gas Pipe Line Corp. v. FERC*, 866 F.2d 477, 479 (D.C.Cir.1989).

The Commission responds, first, that there is well-established precedent for treating pipelines as mere conduits for the flow of refunds from producers to consumers. *See, e.g., Public Utils. Comm'n of Cal. v. FERC*, 24 F.3d 275, 278 (D.C.Cir.1994). Second, the FERC explains that accepting Williams' rates "subject to refund" means simply that the agency would order refunds if appropriate after the remand proceedings in *Colorado Interstate*, not that Williams was expected to pay the tax monies into escrow (or take equivalent steps) in order to assure that they would be available if refunds were ordered. Third, the Commission maintains that it could

not have directed Williams to set up an escrow arrangement because the pipeline was obligated by contract to pay producers the amount of the Kansas tax. The Commission points to § 601(c) of the NGPA, 15 U.S.C. § 3431(c), which guarantees a pipeline full recovery of its gas purchase costs.

The Commission's arguments are not convincing. Surely Williams' contractual obligation does not extend to paying to producers sums unlawfully recovered. While § 601(c) requires that a pipeline be allowed fully to recover its gas purchase costs, that provision also authorizes the Commission to deny recovery of costs that are unjust or unreasonable. Moreover, the Commission would not have violated § 601(c) by requiring that the taxes be placed in escrow while the agency determined whether they could indeed be recovered under § 110. An escrow arrangement would have preserved the rights of all parties. If the Commission ultimately decided that the taxes were recoverable under § 110, then the producers would be entitled to the amount in escrow, including any accrued interest. If, as happened, the Commission decided that the taxes were not recoverable, the amount in escrow could have been refunded to the ratepayers (again, with interest). In either event, the pipelines would have recovered their full gas purchase costs.

Regardless whether the Commission abused its discretion by failing to require an escrow or its equivalent—a matter we need not decide today—the MPSC's petition for review must be denied. Insofar as it seeks prospective relief, the issue is moot: Well-head prices have been totally deregulated since 1993, there are no longer any maximum lawful prices for producer sales, and whether a producer recovers severance taxes is a matter of negotiation between buyer and seller. As for monetary relief, it is too late now for the Commission to require that Wil-

liams pay the severance taxes into escrow; the pipeline has long since paid the monies to the producers.

Nor does the MPSC make out any legal or equitable principle that would suggest holding Williams accountable for the Commission's failure to protect consumers. The pipelines were, as the Commission has reminded us, mere conduits; they had no financial interest in this dispute. The Commission's failure to impose an escrow or other arrangement did not benefit the pipelines, and it is not clear why they should be at risk because the FERC may have been remiss. Nor was Williams obliged either by contract or by regulation to take any precaution against the possibility that a producer would fail to refund monies due to consumers. Therefore, there is no ground upon which the court can say that the Commission was required to hold the pipeline—which was charged first with the task of collecting tax payments and then of distributing tax refunds—liable if the responsible producer defaults on its refund obligation.

III. Conclusion

The Commission's interpretation of § 110 of the NGPA is in all respects reasonable. The Commission properly rejected the Producer Petitioners' proposal that it allow recovery of any tax that was "measurably attributable" to production. That standard is overbroad and unwieldy, and we criticized it as ambiguous in *Colorado Interstate*. The agency reasonably determined that the Kansas *ad valorem* tax is not a severance tax within the meaning of § 110. The Kansas tax is a function of numerous factors other than production, with the result that producers of equal volumes of gas may be taxed very different amounts; and the tax falls upon each unit of reserves each year, rather than once at the time of extraction. Further, the Producer Petitioners are mistaken in their

assertion that non-recovery of a property tax based in part upon production is a disincentive to produce.

The Commission reasonably determined that both the Wyoming and the Colorado *ad valorem* taxes were recoverable as severance taxes under § 110 of the NGPA. The Wyoming tax is assessed upon the volume of gas removed from the well; it is a "one time only" tax, based upon the value of the gas when produced. That the state treats the tax as a property tax is of no moment if, in the terms of § 110, it is "imposed on the production of natural gas." 15 U.S.C. 3320(c). The Colorado tax, also administered as a property tax under state law, is computed as a set percentage of the market value of the gas removed from a well during the tax year. That is "plainly . . . similar enough to a production tax to qualify under § 110," *Colorado Interstate*, 850 F.2d at 772.

Producers are liable to refund all Kansas *ad valorem* taxes collected with respect to production since October 1983. An agency adjudication should be applied retroactively unless new law is relacing clearly defined old law and reasonable reliance interests must therefore be protected. Here the agency did not change the law—rather, the Congress did when it enacted the NGPA in 1978—nor was there any showing that the producers had relied, let alone detrimentally or reasonably relied, upon the continuing validity of the agencys interpretation of the NGA. There is no substantive reason, therefore, to deny customers all the relief to which they are entitled. The customers are limited, however, to recovery of taxes paid with respect to production since October 1983 because that is the earliest date for which any argument has been preserved in this proceeding to review.

Finally, the court will not require the Commission to make the Williams pipeline a guarantor of the producers'

obligation to refund the Kansas tax. Although an escrow arrangement would likely have preserved the rights of all parties, the Commission did not impose one, and no party has pointed to any legal or equitable principle by which the agency can be required to hold a pipeline accountable for the agency's own oversight.

For these reasons, we deny the petitions for review filed by the Missouri Public Service Commission and the Producer Petitioners, and we grant the petition for review filed by the Public Service Company of Colorado.

So ordered.

SENTELLE, Circuit Judge, concurring:

I join without reservation in the holding of the court. I write separately only to place a little distance between myself and what I deem to be an overstated dictum. After describing a hypothetical tax, the majority states that with the majority's proposed variations "the Kansas tax would, in our view, be sufficiently like a tax 'imposed on the production of natural gas' to be recoverable under § 110." Maj. op. at 1485. As no such tax is before us, for us to authoritatively render an opinion on what it would be constitutes nothing less than the advisory opinion that Article III courts have held ourselves unable to render since the earliest days of constitutional jurisprudence. *See, e.g., Flast v. Cohen*, 392 U.S. 83, 96, 88 S.Ct. 1942, 1950, 20 L.Ed.2d 947 (1968) ("[T]he oldest and most consistent thread in the federal law of justiciability is that the federal courts will not give advisory opinions." (Internal quotations and citations omitted)); WRIGHT, MILLER & COOPER, 13 FEDERAL PRACTICE AND PROCEDURE § 3529.1 (1984) (detailing the long history of the rule forbidding advisory opinions). We have already, in my view, crossed the line of appropriate Article

III jurisprudence in dealing with § 110 tax treatment when the prior panel stated "[i]f a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769, 772 (D.C. Cir.1988). I think it time we quit advising state legislatures on how to draft their tax statutes and confined ourselves to construing the statutes actually before us.

APPENDIX F

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

No. 87-1141

COLORADO INTERSTATE GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

MOBIL OIL CORP., NORTHERN NATURAL GAS CO., ASHLAND EXPLORATION, INC., PENNZOIL CO., PHILLIPS PETROLEUM CO., *et al.*, TENNECO OIL CO., CHAMPLIN PETROLEUM CO., PANHANDLE EASTERN PIPE LINE CO., TRUCKLINE GAS CO., TEXACO, INC. and TEXACO PRODUCING, INC.,

Intervenors.

PETITION FOR REVIEW OF AN ORDER OF THE FEDERAL ENERGY REGULATORY COMMISSION

Argued March 4, 1988
Decided June 28, 1988

Before RUTH BADER GINSBURG, BUCKLEY and WILLIAMS, Circuit Judges.

Opinion for the Court filed by Circuit Judge WILLIAMS.

WILLIAMS, Circuit Judge:

The National Gas Policy Act of 1978 (the "NGPA" or the "Act"), 15 U.S.C. §§ 3301 *et seq.* (1982), sets ceiling prices for certain sales of natural gas. Under § 110, producers may raise their prices above these ceilings "to the extent necessary to recover . . . [s]tate severance taxes." 15 U.S.C. § 3320(a) (1982). Such taxes are in turn defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." *Id.* § 3320(c). The Federal Energy Regulatory Commission has classified Kansas's *ad valorem* property tax as a severance tax under § 110. Colorado Interstate Gas Company and Northern Natural Gas Company,[1] interstate pipelines that buy price-regulated natural gas, object to this classification.

The Commission has stated by way of explanation that the tax is "based on production factors." *Northern Natural Gas Co.*, 38 FERC ¶ 6,062 (1987), at 61,176. This is undoubtedly so: past production is used to estimate the net present value of future production from a gas-producing property, and thus the property's taxable value. But that link is not necessarily enough. The capital value of any property is in essence the net present discounted value of its anticipated income stream; this is true even for a shirt, which generates a stream of (nonpecuniary) income in the form of satisfaction as it is worn. We conclude that the Commission's treatment of the issue fell short of reasoned decisionmaking. It failed

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[1] In this court Colorado Interstate is petitioner and Northern Natural intervenor; in the proceedings below they occupied the opposite roles. We refer to them both collectively as petitioners.

to offer any principle for determining what relation to production is enough for a tax to qualify under § 110. That failure is underscored by its inability to supply a persuasive explanation for simultaneously denying severance tax treatment for Texas's seemingly indistinguishable tax.

I.

The Commission's predecessor, the Federal Power Commission (here also referred to as the Commission), first had occasion to give separate treatment to state severance taxes when, in setting producer rates under the Natural Gas Act of 1938, 15 U.S.C. §§ 717 *et seq.* (1982), it abandoned the evidently impossible task of setting them individually for each producer and started to set them for a single producing area on the basis of average production costs. In *Area Rate Proceeding (Permian Basin)*, 34 FPC 159 (1965), *aff'd sub nom. Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968), the first regional rate order, it allowed producers to add on to the ceilings "the full amount of taxes actually incurred either in Texas or New Mexico." *Id.* at 206. Although the Commission did not explain the separate treatment, one may surmise that it regarded it as approriate because the state boundary formed a bright line between the two different cost levels. Thus there was not the same practical need to use *average* figures for severance taxes as there was for other costs. The Commission again followed this approach when it adopted national ceilings in *Just and Reasonable National Rates for Sales of Natural Gas*, Opinion No. 699, 51 FPC 2212, *reh. denied in relevant part*, 52 FPC 1604 (1974), *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir.1975), *cert. denied sub nom. California Co. v. FPC*, 426 U.S. 941, 96 S.Ct. 2660, 49 L.Ed.2d 394 (1976). There it provided generically for

adjustment of the national rates upward for "all . . . production, severance, or similar taxes." *Just and Reasonable National Rates, supra,* at 2301-02. The words are, of course, exactly those used in part of § 110's definition of allowable severance taxes, though § 110 slightly alters the order.

In Opinion No. 699 the Commission did not explicitly state why producers should be able to recover severance or production taxes but not, say, property taxes. The reason that immediately comes to mind, of course, is that non-recovery of a cost that varies with production will work as a disincentive to production, while non-recovery of invariant costs will not. A production tax is a cost of producing, a property tax a cost of holding an asset. Indeed, to the extent that extraction reduces the base against which a property tax is applied, its imposition may tend to accelerate production. *Compare* Anthony Scott, Natural Resources: The Economics of Conservation 195-96 (Carleton Library ed. 1973) (effects of property tax) *with id.* at 185 (effects of production tax). A special feature of natural gas (or any "fugacious" resource) blurs the distinction: in a reservoir with multiple producers, the extracton by a taxpayer's fellow owners may have far more effect on the annual decline in a property's recoverable reserves than his own.

In October 1974, at the behest of the Kansas State Corporation Commission, the Commission declared that Kansas's *ad valorem* tax on "all oil and gas wells, producing or capable of producing oil or gas in paying quantities," Kan.Stat.Ann. § 79-329, was eligible for Opinion No. 699's adjustment. Opinion No. 699-D, 52 FPC 915 (1974).

Without claiming to grasp the refinements of the Kansas tax, we can briefly describe its calculation. The

market value of annual production is calculated by multiplying past production (averaged over a three- or five-year period where available) by the price actually paid the producer on January 1 of the assessment year. Kansas then capitalizes annual production (i.e., infers a present capital value from income expected to be received over the future) by multiplying it by a "present worth factor" or "PWF."

As would any capitalization formula, the PWF incorporates an assumed discount rate and expectations as to future price changes. Because natural gas is an exhaustible resource, the PWF also builds in assumptions (or information) about rates of decline in production and the probable length of production; these naturally vary from property to property. The Kansas Department of Revenue has calculated PWFs for many specific Kansas gas fields, ranging from 6.30 for the Hugoton (above 3000 feet) to 2.50 for the Glick. *See* Kansas Oil & Gas Appraisal Guide (1986), Joint Appendix (J.A.) 83, 98. For "all other Kansas gas fields," Table B sets forth PWFs for rates of production decline experienced and for either a five- or eight-year estimated future life. *See* Appraisal Guide, J.A. at 101. The PWFs in Table B range from 3.915 (for a zero decline rate and an eight-year life) to .673 (for a 50% decline rate and a five-year life). After annual production is multiplied by the PWF, the resulting figure is adjusted downwards for operating costs and upwards for the assumed value of equipment. Although production plays an important role in tax computation, the variation caused by other elements—included because of the state's interest of ascertaining capital value —may make the ultimate tax on equal production vary nearly by a factor of ten.

The Commission found the Kansas tax "similar" to a production or severance tax within the meaning of its

offset rule because "the bulk of the Kansas *ad valorem* tax is based upon production factors, and, as such, is in fact, a severance or production tax merely bearing the title 'ad valorem tax.'" *Just and Reasonable National Rates for Sales of Natural Gas*, Opinion No. 699-D 52 FPC 915 (1974).

Two years later the Commission found that Texas's *ad valorem* tax on real and tangible personal property was not eligible for add-on treatment under Opinion No. 699. *Mobil Oil Corp.*, 55 FPC 917, 918 (1976). It said that "[a]lthough annual and future gas production is quite naturally used to determine the value of gas properties for tax purposes, the tax itself does not depend on production. It depends on the value of the remaining recoverable reserves." *Id.* We will return later to the meaning and validity of the Commission's efforts to distinguish the two taxes.

In 1978 Congress substantially overhauled federal regulation of natural gas prices by adopting the NGPA. In § 110 it provided for severance taxes, using the words of Opinion No. 699 but adding the phrase "imposed on the production of natural gas." The only directly relevant legislative history is a line in the Conference Report to the effect that "The term 'State severance tax' is intended to be construed broadly." H.R.Conf.Rep. No. 1752, 95th Cong., 2d Sess. 91, *reprinted in* 1978 U.S. Code Cong. & Admin.News pp. 8800, 9007. For several years after its adoption producers and purchasers evidently assumed that the Commission's earlier classification of the two states' taxes would carry over to the new regime.

In 1983, however, Texas gas producers asked that they be allowed under § 110 to add that state's *ad valorem* tax to their rates. The present petitioners in turn asked FERC to overrule Opinion No. 699-D's grant of add-on

status for the Kansas tax. FERC consolidated the petitions and denied both. *Sun Exploration and Production Co.*, 36 FERC ¶ 61,093 (1986). The Texas producers invoked the single fragment of legislative history, but the Commission responded by saying that to fall within § 110 an "*ad valorem* tax still must be one based 'upon . . . production.'" 36 FERC ¶ 61,093 at 61,224. In answering the parties' claim that its treatment of the two taxes was inconsistent, the Commission said they were to be distinguished in terms of "the degree to which production factors are taken into account." *Id.* at 61,224. We will shortly consider the Commission's effort to show that its results fitted that idea. Petitioners sought rehearing of the Kansas aspect of the decision, without success. *Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

Before reaching the merits, we must address a claim, raised by Mobil Oil and other producer-intervenors in support of FERC, that the present challenge is in essence an invalid collateral attack on FERC's 1974 disposition of the Kansas tax in Opinion No. 699-D, which they say became "final in 1976, upon the denial of *certiorari* in the appeal of the *Opinion No. 699* series of orders." Mobil Brief at 3 (emphasis in original). They characterize FERC's more recent orders not as substantive dispositions, but as mere denials of petitioners' requests to "reopen a long-closed record." *Id.* at 4.

As the NGPA provided a statutory standard for the first time and thus seemingly introduced a new legal question (the one fundamentally before us today), this would seem an unpromising defense under any circumstances. Here, FERC's own decision to formally reconsider the Kansas and Texas taxes makes it easy to reject the theory. As this court held recently in *Association of American Railroads v. ICC*, 846 F.2d 1465, 1473 (D.C.Cir.1988), where the ICC asserted that the petitioner's challenge to

a long-standing agency practice was time-barred under the Hobbs Act, once "the agency has opened the issue up anew . . .., its renewed adherence is substantively reviewable." *See also State of Ohio v. EPA*, 838 F.2d 1325, 1328 (D.C.Cir.1988).

II

In evaluating the Commission's handling of the Kansas tax, we start with the recognition that a tax nominally on property may be functionally identical to a production tax. If a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the tax would plainly be similar enough to a production tax to qualify under § 110. Neither Kansas nor Texas does that.

We have already noted the way in which different expectations of aggregate future recovery cause the PWF's to vary radically. Other rules also drive the Kansas tax away from a pure production tax. Kansas gives its assessors general instructions to use actual production figures only to the extent that these figures are helpful in ascertaining a property's value. Appraisal Guide i, 1, 13, J.A. 84, 87, 99. It enjoins its assessors to adjust from the Guide itself where "necessary . . . to comply with the constitutional law of equality and the statutory requirement of assessing said property at thirty per cent of its fair market value in money." Appraisal Guide i, J.A. 84.

Moreover, in 1980 Kansas amended its tax to move it (we think) still further in the direction of a property tax. Recognizing that new wells typically produce at disproportionately high rates, it provided that when a well starts production after July 1, the assessor should discount its annualized rate of production by 40% before proceeding to the remaining calculations. Kan.Stat.Ann. § 79-331(b). Notice it is in fact *annualized* production

that is used; the tax on a property starting to produce December 1 will be far more than one-twelfth that of an equally productive property starting to produce January 1.

On the other hand, we note some rules giving actual current production a greater role than would seem normal for a standard property tax. A well that is capable of production in a major proven field, but is shut-in before production starts, is initially appraised at a simple $20 per foot of depth. *See* Appraisal Guide at 13, J.A. 99. At least for wells with good prospects, this must understate true value. Once shut-in for two years, the well is valued at the salvage value of the equipment, *see* Appraisal Guide at 13, 15, J.A. at 99, 101, again a likely understatement. On this issue, Kansas has manifested a focus on production (rather than on recoverable reserves or productive potential) that is likely to generate valuations below market. Accordingly, the tax's effect on an owner's decision whether to shut in a well may be very similar to that of a conventional severance tax.

As we have already noted, the Commission in Opinion No. 699-D merely observed that "the bulk of the Kansas *ad valorem* tax is based upon production factors." 52 FPC 915 (1974). But it has not systemically analyzed the tax or assessed its operation by reference to any cogent theory of what makes a tax "similar" to a production or severance tax under § 110. It has not identified those features that it believes constitute the production-factor "bulk," much less the features excluded from the bulk. Its treatment of the 1980 amendment is puzzling. While this seems clearly to turn the tax further *away from* pure production, the Commission in 1986 asserted in conclusory terms that "the amendment support[ed] the . . . conclusion that the Kansas *ad valorem* tax is based in substantial part on production." 36 FERC ¶ 61,093, at 61,224.

Equally striking is the apparent irrelevance of the Commission's statements in explanation of its decision to treat Kansas and Texas differently. While saying generally that the difference lay in "the degree to which production factors are taken into account," 36 FERC ¶ 61,093, at 61,224, it did not identify pertinent distinctions. It made three points. First:

> The Texas tax is applied to the assessed cash market value of the remaining recoverable reserves (*i.e.*, real property) in place and unsevered at the time of appraisal each year. The tax assessment is based on factors used to project the prospective *future* income (discounted to present value) that a prospective buyer could reasonably expect to derive from the production and sale of the remaining recoverable reserves in place at the time of appraisal. . . .

36 FERC ¶ 61,093, at 61,224 (emphasis in original). The same can be said of the Kansas tax.

Second, the Commission said that in Texas "[a]ctual current and prior year production data is used only to arrive at a declining rate of production to project future rates of production from the remaining recoverable reserves in place at the time of the appraisal." *Id.* In attempting to differentiate the Kansas tax, it remarked that "while Kansas . . . utilize[s] a present worth factor to evaluate gas properties (because an *ad valorem* tax is a tax on property) *actual* current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the tax." *Id.* at 61,224 (emphasis in original.) The two descriptions seem to vary only in that for Kansas the Commission has italicized "actual" and has tagged the production factors as "significant."

Third, FERC observed that "Texas has had both a severance tax and an *ad valorem* tax for a long time, an indication that Texas looked upon the two taxes as separate and distinct taxes." *Id.* This mystifies us. The issue before the Commission was one of federal law—classifying the taxes by reference to some vision of Congress's purpose in § 110. While conceivably Congress might have intended state labels to control, it seems implausible and no one so argues here. If the test is a functional one, it would seem that the taxing state's outlook on the tax would be relevant (if at all) only as a tie-breaker: in a case otherwise in perfect balance, the state's viewpoint might suggest how assessors would exercise their remaining discretion, and thus determine the outcome. But this presupposes a careful analysis of how the specific rules of the tax actually function. Further, as the Commission's modifying phrase ("for a long time") hints, the distinction is purely historical. By the time of FERC's decision, Kansas too had a severance tax. Kan. Stat.Ann. § 79-4217. We find it hard to imagine any theory under which the *date* of a state's coming to believe its *ad valorem* tax and its severance tax were distinct could rationally guide the classification under § 110.

Before us FERC argues that we should disregard the claims that it distinguished irrationally between the two states. Its basis for the argument is that the decision on the Texas tax was not appealed and so is not before us. This is doubtless true. But the Commission's dissimilar treatment of evidently identical cases, on the same day, seems the quintessence of arbitrariness and caprice. Courts routinely insist that an agency changing direction over time offer a rational explanation of the shift, *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 41-42, 103 S.Ct. 2856, 2865-66, 77 L.Ed.2d 443 (1983); *Greater Boston Television Corp.*

v. FCC, 444 F.2d 841, 852 (D.C.Cir.), *cert. denied*, 403 U.S. 923, 91 S.Ct. 2229, 29 L.Ed.2d 701 (1971); we ask less than that in requiring some plausible distinction for simultaneous, apparently contradictory acts.

Of course under *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 842-44, 104 S.Ct. 2778, 2781-83, 81 L.Ed.2d 694 (1984), any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable, will control. *See also NLRB v. United Food and Commercial Workers Union, Local 23, AFL-CIO*, —— U.S. ——, 108 S.Ct. 413, 421, 98 L.Ed.2d 429 (1987). But we cannot defer to a vacuum. We remand to the Commission for the analysis that so far has been wanting.

In closing we take note of the rather special context of this case. It came to us some 34 years after federal regulation of independent producer prices was initiated by virtue of the decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), and, as it has proved, at a point when statutory change and market forces have brought the system virtually to an end. Many categories of gas are formally deregulated; many others are subject to price ceilings far above what producers can obtain in the market. Regulation holds sway primarily in two quite disparate areas. Many producer-pipeline contracts provide that if the gas is subject to a legal ceiling, that ceiling shall be the price, but that if the gas is deregulated, the market price should control or the parties should renegotiate. *See FERC v. Martin Exploration Mgt. Co.*, —— U.S. ——, ——, 108 S.Ct. 1765, 1768-69, 100 L.Ed.2d 238 (1988). Where the ceiling is above market the effect of continued regulation is thus to enable the producer to secure *more* than the market price. FERC's decision that gas eligible for

both a regulated and a deregulated category should be treated as deregulated, recently upheld by the Supreme Court in *Martin*, will partly extinguish this residual effect of regulation. At the opposite end of the range of price controls, ceilings are below market, but FERC, by Order No. 451, 51 Fed.Reg. 22,168 (June 6, 1986), *appeal docketed sub nom., Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, Nos. 86-4940, *et al.* (5th Cir.), has sought to create room for price renegotiation. Thus any changes by the Commission may be of limited relevance, and FERC's task on remand may be about as inviting as having to make costly repairs on a building slated for demolition.

Nonetheless, we think the law requires the Commission to exercise its interpretive authority, to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently.

We note that the Commission denied petitioners' request for a hearing. Whether one is necessary depends on the Commission's analysis of § 110 and on the alternative means by which the Commission may secure the information that proves relevant. The choice of process lies in FERC's sound discretion.

We grant the petition and remand the case.

APPENDIX G

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. GP83-11-002 and RI83-9-003

COLORADO INTERSTATE GAS COMPANY

ORDER ON COURT REMAND
(Issued December 1, 1993)

Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

On June 28, 1988, the United States Court of Appeals for the District of Columbia in *Colorado Interstate Natural Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988) (*CIG*) remanded to the Commission its decision in *Sun Exploration and Production Co.* and *Northern Natural Gas Co.* (*Sun*).[1] In *Sun*, the Commission held that the Kansas *ad valorem*[2] tax was similar to a severance tax, and thus qualified for reimbursement under section 110 (a)(1) of the Natural Gas Policy Act of 1978 (NGPA). The Commission now reverses its decision in *Sun*, con-

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[1] 36 FERC ¶ 61,093 (1986); *reh'g denied, Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

[2] *See* appendix.

cludes that the Kansas *ad valorem* tax does not qualify under section 110(a)(1) of the NGPA, and orders refunds consistent with this order, effective as of the date of the court's decision.

Introduction

In 1974, in Opinion No. 699, the Commission set a uniform national rate under the Natural Gas Act for producer sales of gas, which could be increased to recover "State production, severance or similar taxes." [3] In Opinion No. 699-D, the FPC held that any State *ad valorem* tax that was "based on production factors" was a "similar tax" which could be added to the national rate.[4] In response to a specific request for a ruling on the eligibility of the Kansas *ad valorem* tax, the FPC held that the tax qualified because "the bulk of the Kansas *ad valorem* tax is based upon production factors." [5] The FPC went on

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[3] *Just and Reasonable National Rates for Sales of Natural Gas*, Opinion No. 699, 51 FPC 2212, 2301-2, *reh'g denied in relevant part*, 52 FPC 1604 (1974), *aff'd sub nom., Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975), *reh'g denied*, 525 F.2d 1261 (5th Cir.), *cert. denied sub nom. California Co. v. FPC*, 426 U.S. 941 (1976).

[4] *See generally*, Opinion No. 699-D, *Just and Reasonable National Rates for Sales of Natural Gas*, 52 FPC 915 (1974), and *Mobil Oil Corp.*, 55 FPC 917 (1976).

[5] On December 31, 1975, the Commission set a national rate for gas flowing in interstate commerce prior to January 1, 1973 and continued to permit reimbursement of "State . . . production, severance, or similar taxes." *Just and Reasonable National Rates for Sales of Natural Gas*, 54 FPC 3090, 3124 (1975), *reh. denied*, 56 FPC 303 (1976), *aff'd in relevant part sub nom. Tenneco Oil Co. v. FPC*, 571 F.2d 834 (5th Cir.), *cert. denied*, 439 U.S. 801 (1978). In updating national rates for the 1975-76 period, the Commission adhered to its standard for tax reimbursement. *National Rates for Jurisdiction Sales of Natural Gas*, 56 FPC 509, 591, *reh. denied in relevant part*, 56 FPC 3698, 2807 (1976), *aff'd sub nom., American Public*

to explain that other states' taxes also could similarly qualify because they were taxes "on the amount of production and the revenues therefrom." However, on March 1, 1976, the FPC held that the Texas *ad valorem* tax was not a production, severance, or similar tax.[6] The FPC explained that although annual and future production of gas was used to determine the value of the gas property being taxed, "the tax itself does not depend on production" but rather "depends on the value of the remaining recoverable reserves." [7] The FPC noted that under the Texas tax "a gas property which had no production at all during a tax period due to a temporary shut-down would still have value and would incur tax liability in the period on that basis." [8]

The NGPA, enacted effective December 1, 1978, set maximum lawful prices (MLP) for the first sale of certain categories of natural gas. Under NGPA section 110(a)(1), the first sale price could exceed the MLP to the extent necessary to recover "State severance taxes attributable to the production of such natural gas." [9] The NGPA defined "State severance tax," as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." [10] The Conference Report accompanying the NGPA stated that the term "State severance tax" is to be "construed broadly" and includes "any tax imposed upon mineral or natural resource production including an *ad valorem* tax on a gross receipts tax." [11]

Gas Ass'n v. FERC, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).

[6] *Mobil Oil Corp.*, 55 FPC 917 (1976) (*Mobil*).

[7] *Id.* at p. 918.

[8] *Id.* at p. 918.

[9] 15 U.S.C. § 3320(a).

[10] 15 U.S.C. § 3320(c).

[11] S. Rep. No. 95-1126, 95th Cong. 2d Sess. at p. 91.

On January 11, 1983, Sun Exploration and Production Company (Sun) petitioned the Commission to issue a declaratory order, retroactive to December 1, 1978, asserting that the Texas *ad valorem* tax is a reimbursable severance tax under section 110. Subsequently, on August 22, 1983, Northern Natural Gas Company (Northern) petitioned the Commission to rescind the holding in Opinion No. 699-D that the Kansas *ad valorem* tax is reimbursable under section 110.[12] On July 23, 1986, the Commission issued the order in *Sun* dealing with both petitions and denying them both on the merits.[13] Although the Commission observed that both the Kansas and Texas taxes were defined by statute as property taxes levied upon the fair market value of remaining recoverable reserves at the time of the assessment, the Commission found that the two taxes differed in "the degree to which production factors are taken into account." The Commission found that the Kansas methodology differed from the Texas methodology insofar as "*actual* current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the Kanssa tax."[14] The Commission found that the Texas methodology only uses actual production to establish the rate of production decline for projecting future production and estimating remaining reserves. Further, the Commission reasoned, Texas has long assessed both a severance tax and an *ad valorem* tax, indicating that Texas considered the taxes to be separate and distinct. The order also rejected the argument that the Texas tax should qualify because of the statement in the Conference

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[12] Numerous parties intervened, including Colorado Interstate Gas Co. (CIG), which supported Northern's petition.

[13] The court upheld the Commission's refusal to dismiss the petitions on grounds of *res judicata*. 850 F.2d at p. 772.

[14] 36 FERC ¶ 61,093, at p. 61,224 (emphasis in original).

Report accompanying the NGPA that the term "State severance tax" is to be construed broadly. The Commission stated that the tax still must be "upon . . . production." [15] Finally, the Commission rejected Northern's various arguments that the Kansas *ad valorem* tax is a property tax.

Northern and CIG filed requests for rehearing regarding the portion of the July 23, 1986 order addressing the Kansas tax. No party filed for rehearing of the Commission's ruling on the Texas tax. On January 28, 1987, the Commission denied rehearing on the same grounds as stated in the July 23, 1986 order.[16] Northern and CIG then sought court review of the Commission's ruling that the Kansas tax qualified under NGPA section 110.

In reviewing the Commission's orders, the court rejected each of the Commission's arguments justifying its decision. The court noted that "a tax nominally on property may be functionally identical to a production tax." [17] However, the court held that to find a tax was similar to a production tax, it would not be sufficient to merely find, as the Commission did, that the "bulk of the Kansas tax is based upon production factors." Rather there had to be a systematic analysis of any tax "by reference to [a] cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." [18] In particular reference to the Kansas tax, the court noted that the Commission had not identified those features that it believes constitute the production "bulk," much less the features excluded from the bulk. The court explained that in Kansas the ultimate tax on equal production may vary

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[15] 36 FERC ¶ 61,093, at p. 61,224.

[16] *Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

[17] 850 F.2d at p. 772.

[18] *Id.* at p. 773.

nearly by a factor of ten "because production is capitalized by multiplying by a present worth factor." [19]

The court also was unpersuaded by the Commission's reasons for treating the Kansas and Texas taxes differently since it found that both statutes assessed the cash market value of remaining recoverable reserves. Accordingly, the court remanded the case to the Commission for an analysis "to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently." [20]

KCC Motion to Reaffirm

On January 31, 1989, KCC filed a motion requesting the Commission to reaffirm its 1987 *Sun* decision.[21] The KCC argues that in its practical operation, the Kansas *ad valorem* tax is similar to a severance or production tax and should qualify under section 110. Kansas asserts that although nothing in the public record reflects the precise source of the language adopted in section 110 of the NGPA, it is reasonable to assume that the Conference Committee accompanying the NGPA meant to adopt the

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[19] *Id.* at p. 771. The Court noted that the present worth factors in Kansas incorporate several assumptions including: an assumed discount rate, expectations as to future price changes, assumptions about rates of decline in production, and the probable length of production.

[20] *Id.* at p. 775. The court noted that with the gradual elimination of federal regulation of natural gas prices, any change by the Commission could be of limited relevance. Since the court's decision, as a result of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L.101-50, 103 Stat. 158, as of January 1, 1993, there no longer is any price regulation of natural gas.

[21] Attached to the KCC motion was the affidavit of Mr. Timothy N. Hagemann, a Kansas certified County Appraiser, which described how the *ad valorem* tax operated in Kansas.

policy of the FPC—permitting Kansas producers to collect the *ad valorem* tax. The KCC asserts that a tax is "similar" to a severance or production tax under section 110 of the NGPA if the tax varies with the amount of natural gas produced.

The KCC states that a property's fair market value varies directly with the amount of gas produced from wells on the property and all other things being equal, a well that produces more gas than a neighboring well in the same field will be appraised at a higher value than the other well. Since the tax in Kansas is proportional to production, the *Sun* decision, that the Kansas tax is similar to a production tax, should be affirmed. KCC argues that to deny reimbursement of the tax would operate as an economic disincentive to production of natural gas.

CIG's Answer

On March 1, 1989, CIG filed an answer to the KCC motion to reaffirm.[22] CIG argues that the Kansas *ad valorem* tax is not assessed primarily on the volume or value of current production and does not constitute a production, severance, or similar tax under section 110 of the NGPA. CIG asserts that the KCC's position—that a tax is similar to a severance or production tax if it varies with the amount of natural gas produced—is no more cogent than the arguments presented by the Commission and rejected by the court in *CIG*. CIG argues that, under section 110, Congress intended that only taxes and certain other specific costs which are directly related to the volume and value of gas currently produced would be reimbursable such as the other NGPA section 110 costs (i.e., gathering, compression, treating, *etc.*) which are volumetrically related to the gas produced and sold. CIG

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[22] Northern filed an answer opposing KCC's motion for the reasons set forth by the court in *CIG*, and by CIG in its answer.

asserts that the Kansas *ad valorem* tax is not assessed on the value of the gas sold and produced in any particular year, but instead is assessed on the value of the gas remaining in the reservoir after each year's production is removed.

CIG further states that in defining severance taxes, Congress used the words of the FPC's Opinion No. 699, but added the phrase "imposed on the production of natural gas." (CIG pet. at p. 13). CIG argues that where a tax is not imposed on production, but instead on the leasehold property, like the Kansas *ad valorem* tax, Congress did not intend that such a tax would be reimbursable. CIG contends that although production plays a role in the assessment of the Kansas *ad valorem* tax, it is not a determinative role. To establish that production is not the determining factor in the tax, CIG points out that two wells in different fields producing equal amounts of natural gas can generate different amounts of tax because the *ad valorem* tax uses a Present Worth Factor [23] in calculating the tax assessment. CIG argues that the KCC has focused on the operation of the Kansas tax within a given field, which conceals the true nature of the tax. While at the "microscopic" field level the tax appears to be one based primarily on the value of production, when examined at the state-wide, "macroscopic" level, as the tax is assessed in the various Kansas producing fields, the full nature of the tax emerges. CIG asserts that when viewed from both perspectives, it is clear that the tax fails to resemble a production or severance tax.[24]

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[23] As described in the Hagemann affidavit, the Present Worth Factor is a complex mathematical function of time, anticipated price escalation, time value of money, discount rate, and a production decline rate.

[24] CIG states that the Commission should not act without a full record and suggests that the Commission establish procedures to

Other Pleadings

On August 5, 1993, Missouri Public Service Commission (Missouri), and Southern Union Gas Company (Southern)[25] moved to intervene out of time, and filed a joint motion for summary reversal of the Commission's determination that Kansas' tax was similar to a production tax. On August 20, 1993, four natural gas producers, who had previously filed in support of KCC's motion, filed an answer opposing the joint motion, and urged the Commission to reaffirm its prior rulings on the Kansas tax.

Discussion

A. *Qualification of the Kansas* Ad Valorem *Tax under Section 110*

Although there are various types of taxes that producers pay, such as real estate taxes, personal property taxes, sales taxes, income taxes, excise taxes, and so forth, section 110 of the NGPA only permits the reimbursement of "State severance taxes borne by the seller" in addition to the ceiling price. These allowed taxes, in turn, are defined by the NGPA as "any severance, production, or similar tax." Other taxes are costs of doing business that the producer was to recover by the collection of the ceiling price. As clarified further in the legislative history, "State

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develop such a record. On April 14, 1989 the KCC responded to CIG's Answer by arguing that the interpretation of section 110 and the interferences that may be drawn from the operation of the Kansas tax call for legal analysis and not a factual evidentiary hearing, and submitted additional affidavits confirming that the description of the tax in the Hagemann affidavit was correct. (KCC motion to Lodge at p. 2.).

[25] Each claimed that it was involved in current proceedings which are dependent on the outcome of this proceeding. The Commission finds that good cause has been demonstrated and grants intervention under Commission rule 214(d)(1), 18 C.F.R. § 385.214(d)(1) (1993).

severance tax" is a statutory term of art that "includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax" and is to be "broadly construed." [26] Upon reconsideration of the Kansas *ad valorem* tax in light of the language of the NGPA, the court's decision, and the facts of this case, including the text and application of the Kansas statute, the Commission finds that the tax does not qualify under section 110(a)(1) of the NGPA. The Commission finds that, for reasons as argued by CIG and Missouri, and as clarified further below, the Kansas *ad valorem* tax is not similar to a severance tax and is, instead, a non-qualifying personal property tax.

1. Standards for Analyzing the Kansas *Ad Valorem* Tax

The Commission in *Sun* applied the standard that the Kansas tax qualified under NGPA section 110 because "actual current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the tax." [27] This standard appears to be a refinement of Opinion No. 699-D's broader statement that, to be deemed similar to a severance tax, the "bulk of the tax" must be based on "production factors." On review of these standards, we find that they are too vague and subjective, and improperly permit property taxes on the present value of reserves and lease properties in the state to qualify. Past or current production volumes and revenues are indeed "production factors" but they are factors that are used in judging the present value of all estimated future production from a lease or

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[26] H.R. Cong. Rep. No. 95-1752, 95th Cong. 2d Sess. 91 (1978), 1978 U.S. CODE Cong. and Ad. News 8983, 9007.

[27] 36 FERC ¶ 61,093, at p. 61,224.

well.[28] Since the resulting valuation is of the remaining reserves, a tax on that value is a property tax and cannot qualify for reimbursement under section 110. Further, it is not feasible to establish any precise standard for deciding whether production is significant enough in the calculation of the Kansas *ad valorem* tax to qualify its bulk as being similar to a severance tax. Accordingly, we will not attempt to apply those standards here and, as directed by the court, will clarify the standard for analyzing whether the Kansas *ad valorem* tax qualifies under section 110.

At the outset, we believe that section 110's allowance for taxes "similar" to severance taxes was meant to reflect Congress' intent that the substance of the tax, not its mere label, be dispositive of the issue. Thus, the fact that the subject Kansas tax is titled as an *ad valorem* tax is of no importance to the resolution of the issue here. However, by the same token, we believe that the substance of the tax must fit some common, historical definition of a severance tax. By Congress' own definition such a tax must be "upon" gas production or the value thereof and not, for example, on personal property. It is the tax basis —current production or personal property—that dictates whether the Kansas *ad valorem* tax qualifies under section 110.

Accordingly, to be deemed "similar to" a severance tax, a tax must have the substantive characteristics of a severance tax, and not a property tax. There are two essential characteristics of a severance tax. First, a severance tax is a tax on the act of severing, i.e., removing, a com-

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[28] The fact that current producing rates may be one factor considered in valuing the fair market value of a gas producing property merely reflects the fact that potential purchasers of such a property will naturally value it greater if it is producing high volumes of gas. In such cases, the cashflow from the property is a known fact and the investors can expect to recover their investment more quickly than if daily production is low.

modity from the earth. A severance tax is *on* the volume or value of the commodity *removed*, as assessed at the time of removal. A property tax is on the value of assets *remaining* in or on the earth at the time of the assessment. Thus, as relevant here, a gas severance tax is on the volume or value of the gas the moment it is produced; a property tax on gas leases or wells is on the value of the gas remaining in the ground as well as on the value of wells and other production assets on the lease, at the time of the tax assessment.[29]

Second, a severance tax in its purest sense is a tax on *each* Mcf or MMBtu of gas production, or the value thereof, *at the time of production*, although the state may bill the tax on a monthly or annual basis or may use some form of averaging of the production over the tax period.[30] The key point is that each time a single unit of gas is produced (i.e., "severed from the earth"), and only at that time, a severance tax liability arises directly proportional to the price and/or volume of the gas produced. There is

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[29] The value of such production, in turn, is a direct function of the volumes produced and the price obtained for the gas, but may also reflect a netting out of the producer's cost of production, gathering or other factors. If there is no sale of the gas production, as in the case of gas used for gathering system fuel, or if the sale is at a location otherthan [sic] the wellhead, some states may require some sort of wellhead market value price be imputed to the gas for the purpose of the severance tax.

[30] Thus, a tax on average or total production or production revenue over a current tax period, such as a tax year, could qualify as a severance tax since it is a surrogate for assessing the tax on each Mcf or MMBtu produced, or the revenue therefrom, during that period. As the court in *CIG* noted:

> If a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the tax would plainly be similar enough to a production tax to qualify under § 110. *CIG* at p. 779.

However, the Court specifically held that neither Texas nor Kansas does that. *Id.*

a discrete event that triggers the severance tax liability—the production of a unit of gas. And, once the unit of gas is produced and the severance tax is applied to it, that unit of gas is never again subject to the severance tax. On the other hand, a property tax on gas leases and wells can be on what an assessor estimates as the net present value of *all* expected *future* production from the lease or wells, and may reflect all future expected costs and prices, as well as future depreciation, salvage value of facilities and so forth and will be based, in part, on current and historical costs and production data. Further, and unlike a severance tax, a property tax is applied to a unit of gas reserves each year—year after year—until that unit of gas finally is produced and removed from the property being valued.

2. Application of Principles to the Kansas *Ad Valorem* Tax

Applying these common, historic principles to the Kansas *ad valorem* tax, we find that it is a tax on property, not on production, and, therefore, does not qualify for reimbursement under section 110.[31] On its face, and as

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[31] In this regard, we find that Kansas' own section 79-4217, which is described as an excise tax on the "gross value" of gas "severed from the earth," fits exactly the definition of an eligible "State severance, production, or similar tax." The Kansas severance tax, Kansas Stat Ann.79-4217, provides, in pertinent part, as follows:

> Mineral severance tax; imposition of tax; rate; measurement of production; exemptions. (a) There is hereby imposed an excise tax upon the severance and production of coal, salt, oil or gas from the earth or water in this state for sale, transport, storage, profit or commercial use, subject to the following provisions of this section. * * * Such tax shall be applied equally to all portions of the gross value of each barrel of oil severed and subject to such tax and to the gross value of the gas severed and subject to such tax. The rate for such tax shall be 8 percent of the gross value of all oil or gas severed from the earth or water in this state and subject to the tax imposed under this act. * * *

applied by the state appraisers,[32] the Kansas *ad valorem* tax statute establishes a tax on the present value of personal property. Past and current production is used to estimate future, total production capability of the lease or well which, in turn is used to assess the present value of the gas reserves at the time of the tax assessment. The present value of wells and other leasehold equipment is also included. Like any tax on the value of gas reserves, "production factors" are a significant part of the valuation process. But the thing being valued and taxed is not each Mcf or MMBtu of current production at the time of production; it is the present value of lease property, including the gas reserves remaining in the ground, that is being valued and taxed. Hence, each year—year after year—an Mcf of gas reserves in Kansas will continue to be valued and taxed under the Kansas *ad valorem* tax until that Mcf is eventually produced and sold. Only when that Mcf of gas is produced and sold, does the producer become subject to a tax that does qualify as a severance tax under section 110, i.e., section 79-4217 of the Kansas statute.

The affidavit submitted by CIG confirms that the Kansas *ad valorem* tax is primarily an asset or property tax, rather than a production or severance tax because it is based upon "the present worth of the anticipated reserves" [33] less the costs of operation. Thus, it is quite simply, a tax on the current net value of recoverable reserves. As CIG argues, what is being taxed "is not the value of current production, but instead, the value of the leasehold interest, recognizing that current production is a 'yardstick' by which the value of the leasehold is measured." [34] Also, contrary to the KCC, the fact that the

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[32] *See* appendix.

[33] Hagemann affidavit, p. 3.

[34] CIG Ans. at p. 25.

Kansas *ad valorem* tax may be greatly reduced in the case of a shut-in well does not turn the tax into a severance tax. That would be a case of the tail wagging the dog. This one feature of the tax that applies in that narrow circumstance when there is no production is not indicative of how the body of the statute operates when there *is* production. When there *is* production, the tax is applied just like any other property tax. In any event, when there is no production, there still can be an *ad valorem* tax assessed on the well and other lease property. A true severance tax only applies when gas is produced.

We also concur with the court's analysis that the 1980 amendment supports the view that the Kansas *ad valorem* tax is a property tax. The amendment requires that current actual production from a new well cannot be the basis for the tax if future production rates from the well are expected to be lower. Furthermore, our decision here is not contradicted by the 1982 amendment (section 79-4219) of the Kansas statute. That section provides that taxpayers who are subject to *ad valorem* taxes get a credit to the Kansas severance tax (section 79-4217) in an amount equal to 1 percent of the gross value of gas severed and taxable under the severance tax. Because current production may be factored into the *ad valorem* tax valuation (albeit to better assess expected future production and, therefore, the value of the remaining reserves), and also is taxed under the severance tax provision, the credit simply reflects that a small portion of the *ad valorem* tax may be somewhat redundant with a small (1 percent) portion of the severance tax. The relative insignificance of the credit *vis-a-vis* the total *ad valorem* tax base and resulting tax liability makes it abundantly clear that the *ad valorem* tax ultimately found due on a property is not "upon" current production to any significant degree.

B. *Date of Application of the Ruling of this Case*

Since we have concluded that the Kansas *ad valorem* tax does not qualify as being similar to a state severance tax under NGPA section 110, we must also determine the effective date of our decision. The issue before us is whether and, if so, to what extent this ruling should be made retroactively effective. A finding that our ruling should have prospective effect would have no effect at all inasmuch, as effective January 1, 1993, the statutory ceiling prices on natural gas were removed. Further, the date of enactment of the NGPA, December 1, 1978, is the maximum limit of potential retroactivity here because we have found that the Kansas *ad valorem* tax does not qualify under section 110 of the NGPA and, hence, reimbursement of that tax in addition to the ceiling violates the Congressionally-set maximum lawful prices. As discussed below, we do not view our authority as limited by the relevant case law to a choice only between maximum retroactivity and prospective application. Accordingly, we believe that there are a number of other relevant dates that could be considered for purposes of refunds: for example, the date the applicants sought a declaratory order in the instant proceeding (August 22, 1983); the date of the Commission's order in *Sun* (July 23, 1986); or the date of the *CIG* decision (June 28, 1988).[35] Upon review of the relevant court standards of administrative retroactivity, we conclude that our ruling should be applied retroactively to the date of the court's decision in *CIG*, June 28, 1988.

In its recent decision in *Williams Natural Gas Co. v. FERC*, Nos. 90-1545 and 91-1543, (September 21, 1993)

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[35] We do not consider the date of Opinion No. 699-D, October 1974, as a viable option, since that related to the NGA and this proceeding involves application of the statutory definition under the NGPA. Moreover no party has urged such a date.

(*Williams*), the United States Court of Appeals for the District of Columbia Circuit discussed the question of retroactive application of administrative agency rulings. The court explained that, although a precise statement of the factors to be considered has varied from case to case, it has typically applied the following factors initially set forth in *Retail, Wholesale & Dept. Store Union v. NLRB*:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.[36]

However, the court in *Williams* did not review each factor as so stated and, instead, stated that, in applying the various versions of the *Retail Union* test, there has emerged "[a] basic distinction . . . between (1) new applications of law, clarifications, and additions, and (2) substitution of new law for old law that was reasonably

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[36] 466 F.2d 380, 390 (D.C. Cir. 1972) (*Retail Union*). In the past the Commission has applied the standards for judicial retroactivity set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (*Chevron v. Huson*). *See, e.g., Dorchester Gas Producing Company*, 36 FERC ¶ 61,049 (1986), *aff'd Dorchester Gas Producing Co. v. FERC*, 848 F.2d. 636 (5th Cir. 1988). In *District Lodge 64, Int'l Ass'n of Machinists & Aerospace Workers v. NLRB*, 949 F.2d 441 at p. 447 (D.C. Cir. 1991), the court noted that the *Retail Union* test concerning retroactive application of agency decisions appears substantively indistinguishable from the standard set forth in *Chevron v. Huson*. *But see Harper v. Virginia Dept. of Taxation*, 61 U.S.L.W. 4664 (U.S. June 18, 1993).

clear." [37] The court explained that in the latter context, which may give rise to questions of fairness, "it may be necessary to deny retroactive effect to a rule announced in an agency adjudication in order to protect the settled expectations of those who had relied on the preexisting rule." [38] In the former case, it held, retroactivity is "natural, normal, and necessary." [39] Thus, the court stated, "we have repeatedly held that retroactivity is appropriate when the agency's ruling represents 'a new policy in a new situation,' rather than being 'a departure from a clear prior policy.' " [40]

This case involves a bit of both situations. On the one hand, as the court admonished in *CIG*, the Commission in *Sun* had no clear standard of analyzing state taxes for purposes of qualification under section 110. Today we are announcing that the common, historical standards for distinguishing between severance taxes and property taxes are to be applied. That would suggest full retroactivity. On the other hand, our ruling today clearly reverses an earlier Commission ruling that the Kansas *ad valorem* tax qualifies under section 110. As noted previously, the FPC had held in 1974 that the Kansas *ad valorem* tax was a "severance or production tax merely bearing the title *ad valorem* tax," and eligible for upward adjustment from the applicable national rate. Enactment of NGPA section 110 using the terminology of the FPC, and with the Conference Report stating that the provision concerning reimbursement of severance taxes should be "construed

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[37] *Williams* slip op. at p. 19 (*citing Aliceville Hydro Assocs. v. FERC*, 800 F.2d 1147, 1152 (D.C. Cir. 1986).

[38] *Id.*

[39] *Id.* (*citing NLRB v. Bell Aerospace*, 416 U.S. 267, 294 (1974).

[40] *Id.*

broadly," [41] would, as the court noted in *CIG*, lead producers as well as purchasers to assume that the "Commission's earlier classification of the two states' taxes [Kansas and Texas] would carry over to the new regime." [42] Moreover, the Conference Report went on to add that the term severance tax "includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax." [43] That would suggest no retroactivity.

We think that the balance tips in favor of partial retroactivity. The "settled expectations of those who had relied on the preexisting rule" established by the Commission's several prior rulings on the Kansas *ad valorem* tax were changed by the *CIG* decision, not really our own decision today. Before that date, the parties could justifiably expect to recover Kansas *ad valorem* taxes in addition to NGPA ceiling rates with no expectation of a later refund obligation. After that date, given the clear signal by the court in its decision, the parties no longer would have been justified in relying on the Commission's earlier rulings with any assurance that they would not later be required to make refunds of *ad valorem* taxes and could have taken steps to protect themselves, such as establishing an escrow account for such tax reimbursements. Our decision today merely adopts the court's analysis of the issue and rules in a way, we think, fully expected of this Commission by the court. For these reasons, we believe the date of the *CIG* decision most appropriately accommodates the *Williams* criteria, rather than either a fully retroactive application back to December 1, 1978, or a fully prospective application (with no effect whatsoever).

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41 H.R. Conf. Rep. No. 1752, 95th Cong. 2nd Sess. 91, reprinted in 1978 U.S. Code Cong. & Adm. News, pp. 8800, 9007.

42 850 F.2d at p. 772.

43 *Id.*

C. *Refund Procedures*

1. Procedures for Refunds by First Sellers

First Sellers who collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest in full within 180 days after the Commission's final order is issued. The refund period will commence when the Commission's order becomes final.

2. Procedures for the Flowthrough of Refunds by Pipelines

Under the Natural Gas Act, the Commission has jurisdiction over the rates interstate pipelines charge their customers. We establish the following procedures for interstate pipelines to pass through any *ad valorem* tax refunds they receive from first sellers.

a. *Method of Flowthrough by Interstate Pipelines*

Due to the implementation of Order No. 636 [*FERC Statutes and Regulations* ¶ 30,939], interstate pipelines have terminated their PGA clauses, which included a mechanism to pass through any refunds they received. Since this mechanism was used to reduce a pipeline's unrecovered purchased gas costs balance which would normally have been recovered from its customers over the next twelve-month period, this mechanism usually did not result in the flowthrough of refunds to customers in the same relative proportions of the actual overcharges because of changes in purchased gas patterns.

Since the PGAs have been terminated, *ad valorem* tax refunds can no longer be flowed through the PGA clause.

In place of the PGA clause, pipelines have implemented PGA close-out procedures. However, these close-out procedures may result in methodologies that are even more divergent from the proportionate sales ratios reflected in the PGAs. Therefore, to ensure that *ad valorem* tax refunds will be made to customers who overpaid the pipelines and to avoid the problems of allocating these refunds to a pipeline's current customers, the Commission will require interstate pipelines to make a lump-sum cash payment to the customers who were actually overcharged. We will require pipelines to make refunds to the customers actually overcharged within 30 days after receipt of refunds from the producers. If a pipeline does not make refunds within this 30-day period, the interest provisions in section 154.67(c) will be triggered and interest must be paid from the date the pipeline receives the refunds from the producers until the date the pipeline pays refunds to its customers.

The Commission believes that a pipeline should: (1) allocate the refunds between jurisdictional and non-jurisdictional customers; and (2) allocate the total refunds due to the jurisdictional customers who were actually overcharged based on the proportion of each customer's purchases during the refund period compared to the total jurisdictional sales during the refund period. Pipelines would then pay this refund to those customers in a lump-sum cash payment. In any event, pipelines are to process *ad valorem* tax refunds from other pipelines in the same manner as *ad valorem* tax refunds received from first sellers because this procedure will return such amounts to those customers actually overcharged.

Finally, the Commission notes that pipelines will not be required to be guarantors of refunds. However, the Commission urges interstate pipelines to actively pursue refunds owed by first sellers.

b. *Pipeline Refund Reports*

The Commission will require interstate pipelines to file refund reports showing the amounts they received from producers (with principal and interest shown separately) and any producers who still owe refunds. The report must be filed 75 days after the date refunds are paid.

The refund report must also describe the basis a pipeline used to apportion the refunds among its customers and be served on all of the pipeline's customers. These reports will enable the Commission to assure that the customers have received appropriate refunds.

The Commission orders:

(A) The Kansas *ad valorem* tax does not qualify as a production, severance or similar tax under section 110 of the NGPA.

(B) The Kansas Corporation Commission's motion to reaffirm is denied.

(C) The Kansas Corporation Commission's motion to lodge is granted.

(D) The Kansas *ad valorem* tax may not be added to the maximum lawful price under section 110 of the NGPA on or after June 28, 1988.

(E) Any first seller that collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest calculated in accordance with §§ 154.02(c) and (d) of the Commission's regulations, in full within

180 days after the Commission's final order is issued, and shall file a refund report with the purchaser's concurrence within 75 days thereafter.

(F) Interstate pipelines must follow the refund flow-through procedures set forth in the text above.

APPENDIX

The Kansas Ad Valorem Tax

The *ad valorem* tax at issue is part of the general Kansas property tax imposed by Articles 79-1 through 79-28, Kansas Statutes Annotated. The properties are assessed by local assessors and taxed by local taxing jurisdictions within Kansas. Section 79-329 of the Kansas Statute defines properties that are capable of producing oil or natural gas in paying quantities, together with all casing, tubing or material thereon, as "personal property" and, therefore, subject to Kansas *ad valorem* taxes. Section 79-330 provides that, in valuing such properties for the purpose of tax assessment,

> there shall, in addition to the value of all oil- or gas-well material in or upon the leasehold properties, be made such valuation of the oil or gas wells as would make a reasonable and fair value of the whole property.

Section 79-331(a) states that in determining the value of oil or gas leases or properties, the appraiser shall take into consideration:

> the age of the wells, the quality of the oil or gas being produced therefrom, the nearness of the wells to market, the cost of operation, the character, extent and permanency of the market, the probable life of the wells, the quantity of the oil or gas produced from the lease or property, the number of wells being operated, and such other facts as may be known by the appraiser to affect the value of the lease or property.

Section 79-331(b) establishes an exception to section 79-331(a) in the case of new wells. Paragraph (b) provides that if a new well commenced production on or

after July 1 of the preceding year, the actual production during the remainder of that preceding year will be reduced to 60 percent of that actual volume and then annualized. In *Sun*, the Commission explained that this latter provision was designed to correct for the unusually high production rates of new wells ("flush production") in estimating production in subsequent periods. 36 FERC ¶ 61,093, at p. 61,224. Section 79-501 requires that tangible personal property shall be appraised at its fair market value which section 79-a defines as "the amount in terms of money that a well informed buyer is justified in paying and well informed seller is justified in accepting for property in an open and competitive market, assuming the parties are acting without undue compulsion." Section 79-a goes on to list various factors that are to be considered in determining fair market value, in addition to sales, such as location, depreciation, cost of *inter alia*, by capitalization of net income.

In *CIG*, the court described how the Kansas *ad valorem* tax is calculated: [1]

> The market value of annual production is calculated by multiplying past production (averaged over a three- or five-year period where available) by the price actually paid the producer on January 1 of the assessment year. Kansas then capitalizes annual production (i.e., infers a present capital value from income expected to be received over the future) by multiplying it by a "present worth factor" or "PWF."
>
> As would any capitalization formula, the PWF incorporates an assumed discount rate and expectations as to future price changes. Because natural gas is an exhaustible resource, the PWF also builds in assumptions (or information) about rates of decline in pro-

[1] 850 F.2d at p. 771.

duction and the probable length of production; these naturally vary from property to property.

* * * * *

The PWFs in Table B range from 3.915 (for a zero decline rate and an eight-year life) to .673 (for a 50% decline rate and a five-year life). After annual production is multiplied by the PWF, the resulting figure is adjusted downwards for operating costs and upwards for the assumed value of equipment. Although production plays an important role in tax computation, the variation caused by other elements —included because of the state's interest of ascertaining capital value—may make the ultimate tax on equal production vary nearly by a factor of ten.

The court's description is consistent with the description of how the tax is determined in the affidavit of a Timothy N. Hagemann, a Kansas Certified County Appraiser, submitted with the Kansas Corporation Commission's (KCC) motion to Reaffirm. The affidavit states that:

(1) The appraiser first determines the well's "total average gas production." For a property in a major proven gas field, the total average production is the numerical average of production for the previous five years or the adjusted volume, after consideration for overages, underages and anticipated curtailed volumes. If the property is located in a field that is not considered a major field, the total average production is the numerical average of the past year's production.[2] The amount of remaining recoverable reserves are not taken into consideration.

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[2] According to the Hagemann affidavit, the appraiser may adjust actual production figures to account for abnormal events. Thus, if production had been curtailed and then suddenly was resumed, the

(2) The appraiser then multiplies the absolute average production by the "net price received." The net price received is the price of gas as of January 1 of the tax year.

(3) Next, the appraiser multiples the estimated gross income stream by the "present worth factor" or "present value factor." The present worth factor is the product of (1) the rate of decline of gas reserves, (2) the assumed rate of increase in the value of gas, and (3) the present value discount factor. Present worth factors are promulgated by the Department of Revenue for each major proven gas field and are identical or all properties within the field. For properties in other fields, the appraiser must calculate the reserve decline rate based on the prior two year's production.

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(4) Finally, the appraiser adjusts the gross reserve value by deducting an allowance (fixed by the Department of Revenue for each field) for the present value of future operating costs. The appraiser also adds a standard amount to reflect the value of equipment, if applicable.

The result of all these calculations is the total "appraised value of gas production." The applicable tax rate is applied to 30 percent of the total appraised value.

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appraiser would adjust his asssessment upward to reflect the anticipated increase in production for the upcoming year. Conversely, if a well has been over-producing and has exceeded its allowable production, the assessment will be lowered to reflect the anticipated curtailment.

APPENDIX H

BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP83-11-000

SUN EXPLORATION AND PRODUCTION COMPANY

Docket No. RI83-9-000

NORTHERN NATURAL GAS COMPANY

ORDER DENYING PETITION FOR DECLARATORY ORDER THAT THE TEXAS AD VALOREM TAX IS A REIMBURSABLE TAX UNDER SECTION 110 OF THE NATURAL GAS POLICY ACT OF 1978, AND DENYING PETITION TO REOPEN, RECONSIDER, AND RESCIND OPINION NO. 699-D AS IT PERTAINS TO THE KANSAS AD VALOREM TAX *

(Issued July 23, 1986)

Before Commissioners: Anthony G. Sousa, Acting Chairman; Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

On January 11, 1983, Sun Exloration and Production Company (Sun) petitioned the Federal Energy Regulatory Commission (Commission), pursuant to Rule 207 of the Commission's Rules of Practice and Procedure,[1]

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* The issues in both dockets are related. Accordingly, we are issuing a single order.

[1] 18 C.F.R. § 385.207(a)(2) (1985).

to issue a declaratory order, retroactive to December 1, 1978, stating that the Texas *ad valorem* tax [2] is a state severance tax within the meaning of section 110 of theNatural [sic] Gas Policy Act of 1978 (NGPA).[3] Notice of Sun's petition was published in the *Federal Register* on February 10, 1983 (48 Fed. Reg. 6164), and companies filed petitions to intervene.[4]

On August 22, 1983, Northern Natural Gas Company (Northern) petitioned the Commission to rescind Opinion No. 699-D [5] issued by the Federal Power Commission (FPC) (the Commission's predecessor) insofar as it pertained to the Kansas *ad valorem* tax. In that Opinion the FPC held that the Kansas *ad valorem* tax was a tax primarily based on production factors and thus producers could adjust upward the national rate established in Opinion No. 699 [6] by the amount of that tax. Northern asserted that, based upon Commission precedent, and subsequent Kansas legislative action, the Kansas *ad valorem* tax should be determined to be a property tax, rather than a "production, severance or similar tax," and that Northern was no longer obligated to reimburse Kansas sellers of gas for the *ad valorem* tax. Notice of Northern's petition was published in the *Federal Register* on October 4, 1983 (48 Fed. Reg. 45,287), and parties

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[2] Tex. Tax Code Ann. §§ 11.01 and 23.01 (Vernon 1982). In 1981 Texas repealed the existing tax articles and enacted the Texas Tax Code without any substantive change. Sections 11.01 and 23.01 are derived from Tex. Stat. Ann. art. 7145 and 7174 (Vernon 1960).

[3] 15 U.S.C. § 3320 (1982).

[4] *See* Appendix A.

[5] 52 FPC 915 (1974).

[6] 51 FPC 2212 (1974).

filed petitions to intervene both in support of and in opposition to the petition.[7]

Background

In Opinion No. 699, the FPC held that it would permit an upward adjustment in the national rate "for all State or Federal production, severance or similar taxes . . . ." [8] In Opinion No. 699-D, the FPC clarified that a state *ad valorem* tax (i.e., a property tax levied according to assessed value) which is based on production factors, will be considered a severance or production tax. The FPC accepted the argument that "the bulk of the Kansas *ad valorem* tax is based upon production factors," and accordingly it held that the Kansas tax was "a severance or production tax merely bearing the title *ad valorem* tax." [9] However, in *Mobil Oil Corp. (Mobil Oil)*, it held

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[7] *See* Appendix B. A number of parties question Northern's right to seek the relief asserting that the matter was fully adjudicated and is *res judicata*. However, we find that the enactment of the NGPA and the subsequent Kansas legislative action are sufficient "changed circumstances" to warrant the Commission to entertain the petition.

[8] 51 FPC at 2301.

[9] 52 FPC 915 (1974). Kan. Stat. Ann. § 79-329 (1977) provides that "[F]or the purpose of valuation and taxation, all oil and gas leases and all oil and gas wells, producing or capable of producing oil or gas in paying quantities, are hereby declared to be personal property and shall be assessed and taxed as such." Kan. Stat. Ann. § 79-330 (1977) states that, in valuing oil and gas properties, there shall be made "such valuation of the oil and gas wells as would make a reasonable and fair value of the whole property." Finally, Kan. Stat. Ann. § 79-331 (1977) provides that:

> In determining the vaue of oil and gas wells or properties the assessor shall take into consideration the age of the wells, the quality of oil or gas being produced therefrom, the nearness of the wells to market, the cost of operation, the character, extent and permanency of the market, the probable life of the wells, the quantity of oil or gas produced from the wells,

that the Texas *ad valorem* tax was not a "production, severance or similar tax," since "the tax itself does not depend on production [but] depends on the value of the remaining recoverable reserves." [10]

Section 110 of the NGPA codified the FPC's approach by permitting the seller to recover any "state severance tax" borne by the seller, in addition to the applicable maximum lawful price. NGPA section 110(c) and Commission regulation 18 C.F.R. § 271.1101(a)[11] both define a state severance tax as "any severance, production or similar tax, fee, or other levy imposed on the production of natural gas . . . ."

In 1979, after enactment of the NGPA, the Commission held that the West Virginia *ad valorem* tax fell within the menning of "similar tax" because it was based on production factors. In reaching its conclusion the Commission referred to the fact that "gross income derived from gas production" was a factor used in the two valuation methods sanctioned in the West Virginia Code.[12]

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the number of wells being operated, and such other facts as may be known by the assessor to affect the value of the property.

[10] 55 FPC 917 (1976). The Opinion noted that "a gas property which had no production at all during a tax period due to a temporary shut-down would still have value and would incur tax liability in the period on that basis." *Id.* at 918.

[11] 18 C.F.R. § 271.1101(a) (1985).

[12] *Independent Oil & Gas Association of West Virginia*, 7 FERC ¶ 61,094 (*IOGA*). The tax is provided for in W. Va. Code § 11-5-1 (1983). The two methods are capitalization of net income, and the multiplier of gross income. In 1982, the Commission held that the West Virginia tax levied on producers of natural gas for gathering services under the Business and Occupation Tax, W. Va. Code §§ 11-13-1, *et seq.* (1983), fell within section 110 "since it has a basis in gas production." Trio Petroleum Corp. and Waco Oil & Gas Co., 18 FERC ¶ 61,203, at p. 61,412.

Discussion

The two petitions which seek to change the treatment accorded *ad valorem* taxes in Texas and Kansas are related. Both ask that the Commission treat the Kansas and Texas *ad valorem* taxes in the same way.[13] However, Sun urges the Commission in effect to reverse *Mobil Oil* as it pertains to Texas and hold that the Texas tax, like the Kansas tax, is a "similar tax," and that it is eligible for reimbursement. Northern argues that the Commission should follow *Mobil Oil*, rescind that part of Opinion No. 699-D dealing with the Kansas tax, and hold that the Kansas *ad valorem* tax is not a "similar tax," and like the Texas tax, is not eligible for reimbursement. We shall address this argument first, and then address the other arguments raised by Sun and Northern.[14]

The *ad valorem* taxes in Texas, Kansas, and West Virginia are all defined by statute as taxes on real or personal property and as such require an appraisal of the fair market value of the remaining gas reserves at the time of assessment each year. The difference, however, between the Texas tax and the taxes in Kansas and West Virginia is the degree to which production factors are taken into account in the methodology used to appraise gas properties for *ad valorem* tax purposes. The Texas tax is applied to the assessed cash market value of the remaining recoverable reserves (i.e., real property) in place and unsevered at the time of appraisal each year. The tax assessment is based on factors used to project the prospective *future* income (discounted to present

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[13] Sun's petition also argues that the Texas tax is similar to West Virginia's, which in *IOGA*, *supra* note 12, the Commission held was eligible for reimbursement under NGPA Section 10.

[14] None of the arguments raised by intervenors significantly differ from those urged by Sun and Northern in their petitions.

value) that a prospective buyer could reasonably expect to derive from the production and sale of the remaining recoverable reserves in place at the time of appraisal on January 1 of each year. Actual current and prior year production data is used only to arrive at a declining rate of production to project future rates of production from the remaining recoverable reserves in place at the time of appraisal. On the other hand, while Kansas and West Virginia both utilize a present worth factor to evaluate gas properties (because an *ad valorem* tax is a tax on property) *actual* current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the tax. In addition, Texas has had both a severance tax [15] and an *ad valorem* for a long time, an indication that Texas looked upon the two taxes as separate and distinct taxes.[16] Accordingly, we find that there are valid reasons for treating the Kansas *ad valorem* tax as a tax "similar" to a severance tax, and the Texas tax as not similar to a severance tax.

Sun also contends that the legislative history of NGPA section 110 indicates that Congress intended the Commission to give an expanded interpretation to the term "state severance tax," thereby requiring a change in the FPC's conclusion in *Mobil Oil* that the Texas *ad valorem* tax was not similar to a severance tax. Sun cites the Conference Report which stated that "The term 'State severance tax' is intended to be construed broadly. It

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[15] Tex. Tax Code Ann. § 201.051 (Vernon 1982), derived from Tex. Stat. Ann. art. 3.01 and 3.02 (Vernon 1960).

[16] Kansas enacted a severance tax in 1982 (Kan. Stat. Ann. § 79-4217 (1977)). However, the Kansas severance tax permits a 1% credit for *ad valorem* taxes paid on gas properties (Kan. Stat. Ann. § 79-4219 (1977)), showing that Kansas recognizes the *ad valorem* tax as one related to production.

includes any tax imposed upon mineral or natural resource production including an ad valorem tax or a gross receipts tax." [17] This is not persuasive. The discussion in the Conference Report merely recognized that the FPC had permitted any tax that was based on production to be considered a severance tax, regardless of what it was labeled in the state tax code. But to fall within NGPA section 110 the *ad valorem* tax still must be one based "upon . . . production." Accordingly, we see no grounds for reversing *Mobil Oil*, and will deny Sun's petition.[18]

In support of its petition, Northern asserts that a 1980 amendment to the Kansas *ad valorem* tax [19] makes it

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[17] H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. 91, *reprinted in* 1978 U.S. Code Cong. & Ad. News 9007.

[18] With reference to the FPC's statement in *Mobil Oil*, that in Texas shut-in properties still have value for *ad valorem* tax purposes, Sun merely asserts that "in the usual case," shut-in properties are not assessed an *ad valorem* tax (Petition of Sun, p. 3), conceding that this is not required by statute. Moreover, the local assessor has the discretion of assessing a $10 an acre tax on non-producing gas properties.

[19] The amendment added the following two subsections to Kan. Stat. Ann. § 79-331 (1977):

> (b) The valuation of the working interest and royalty interest, except valuation of equipment, of any original base lease or property producing oil or gas for the first time in economic quantities on and after July 1 of the calendar year preceding the year in which such property is first assessed shall be determined for the year in which such property is first assessed by determining the quantity of oil or gas such property would have produced during the entire year preceding the year in which such property is first assessed upon the basis of the actual production in such year and by multiplying the income and expenses that would have been attributable to such property at such production level, excluding equipment valuation thereof, if it had actually produced said entire year preceding the year in which such property is first assessed by sixty percent (60%).
>
> (c) The provisions of subsection (b) of this section shall not apply in the case of any production from any direct offset well or any subsequent well on the same lease.

more evident that the tax is a property tax and not an excise tax (an excise tax is one on the privilege of doing business, not owning property). Northern's argument, even if true, would make no difference, because it does not address the issue of whether the tax, however labeled, is one based on production. In fact, the amendment supports the FPC's conclusion that the Kansas *ad valorem* tax is based in substantial part on production. In *State ex. rel. Stephan v. Martin*,[20] the court explained that the amendment was adopted to address the problem resulting from the fact that a new well's initial production (known as "flush production") is ordinarily not an accurate indication of its production in subsequent periods. However, assessors had failed to take this fact into account in their *ad valorem* assessment, and often merely annualized the flush production. Such annualization led to "a greatly inflated production factor resulting in excessive valuation and assessment . . ."[sic] [21] The amendment was enacted to reduce this overassessment. It is thus clear, beyond question, that the Kansas *ad valorem* tax is based, in large part, on gas production.

Finally, Northern argues that the 1982 Kansas *ad valorem* tax it paid on certain wells, as a percentage of income from those wells, varied from well to well, which establishes "the fact that the Kansas *ad valorem* tax is assessed, not on production, but on remaining recoverable reserves." [22] Northern's argument is flawed because the Kansas *ad valorem* tax is not applied to the current tax year's "gross revenues," but to the "estimated gross income" (determined on January 1 of each tax year) based on *actual* prior years' production volumes. The ratio of

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[20] 230 Kan. 747, 641 P.2d 1011 (1982).

[21] 641 P.2d at 1014.

[22] Petition of Northern, p. 4.

ad valorem tax paid to estimated gross income for 1982, 1983 and 1984 varies only slightly for each of the wells cited by Northern. Thus we find no reason to change the PFC's conclusion that the Kansas *ad valorem* tax is based on production factors.

Neither of the petitioners has advanced arguments that persuade us that the prior decisions on the Kansas and Texas *ad valorem* taxes were erroneous. Nor have they shown that the assessment of these taxes has changed since the decisions were rendered in Opinion No. 699-D and in *Mobil Oil*, which would require a change in those decisions.

The Commission orders:

The petition for a declaratory order, filed in Docket No. GP83-11-000 by Sun Exploration and Production Company, that the Texas *ad valorem* tax is a tax based on production and is reimbursable under section 110 of the NGPA, and the petition filed by Northern Natural Gas Co. in Docket No. RI83-9-000 to reopen, reconsider and rescind Opinion No. 699-D as it pertains to the Kansas *ad valorem* tax, are denied.[23]

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[23] Since no one filed in opposition to the timely motions to intervene, they are automatically granted. 18 C.F.R. § 385.214(c)(1) (1985).

APPENDIX A

Docket No. GP83-11-000

Interventions

Producer-Sellers [1]*—Date of Filing*

1. Texas Oil & Gas Corp.—March 10, 1983

2. Mobil Producing Texas & New Mexico Inc.—March 11, 1983

3. Gulf Oil Corporation—March 21, 1983

Pipeline-Purchasers: [2]*—Date of Filing*

1. Northern Natural Gas Company, Division of Inter-North, Inc.[3]—February 18, 1983

2. Florida Gas Transmission Company—February 22, 1983

3. Colorado Interstate Gas Company—March 3, 1983

4. Lone Star Gas Company, a Division of ENSERCH Corporation [3]—March 7, 1983

5. Panhandle Eastern Pipe Line Company [3]—March 7, 1983

6. Trunkline Gas Company [3]—March 7, 1983

7. United Gas Pipe Line Company [3]—March 11, 1983

8. El Paso Natural Gas Company—March 14, 1983

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[1] Produced-sellers either support, or take no position with respect to Sun's petition.

[2] Pipeline-purchasers either oppose, or take no position with repect to Sun's petition.

[3] Purchasers filing motions to summarily deny Sun's petition pursuant to Commission Rules 212 and 217, 18 C.F.R. §§ 385.212 and 385.217 (1985).

9. United Texas Transmission Company [3]—March 14, 1983

10. Valero Transmission Company [3]—March 14, 1983

APPENDIX B

Docket No. RI83-9-000

Interventions

(A) Petitions to intervene in opposition—Date of Filing

1. Arco Oil and Gas Company, Division of Atlantic Richfield Company—October 17, 1983

2. Amoco Production Company—October 17, 1983

3. Chevron U.S.A. Inc.—October 18, 1983

4. Maurice L. Brown Company—October 19, 1983

5. Gulf Oil Corporation—October 19, 1983

6. Phillips Petroleum Company and Phillips Oil Company—October 19, 1983

7. Mobil Oil Corporation and Northern Natural Gas Producing Company—October 19, 1983

8. Aminoil Inc.—October 19, 1983

9. Champlin Petroleum Company—October 19, 1983

10. Mesa Petroleum Company—October 19, 1983

11. Pennzoil Company, Pennzoil Producing Company and Pennzoil Oil and Gas, Inc.—October 19, 1983

12. Ashland Exploration, Inc.—October 19, 1983

13. Texaco Inc.—October 20, 1983

14. Kerr-McGee Corporation—October 20, 1983

15. Getty Oil Company—October 20, 1983

16. Cities Service Oil and Gas Corporations—October 20, 1983

17. Shell Oil Company—October 20, 1983

18. Sun Exploration and Production Company—October 20, 1983

19. Kansas State Corporation Commission—October 20, 1983

20. Tenneco Oil Company—October 20, 1983

21. Dorchester Gas Producing Company—October 20, 1983

22. Cabot Petroleum Corporation—October 31, 1983

(B) Petitions to intervene in support—Date of Filing

1. Iowa Public Service Company—October 13, 1983

2. Iowa-Illinois Gas and Electric Company—October 14, 1983

3. Colorado Interstate Gas Company—October 14, 1983

4. Iowa Southern Utilities Company—October 17, 1983

5. Northwestern Public Service Company—October 17, 1983

6. Minnegasco, Inc.—October 17, 1983

7. Metropolitan Utilities District Of Omaha—October 19, 1983

8. Interstate Power Company—October 19, 1983

9. North Central Public Service Co.—October 19, 1983

10. Northern States Power Company (Minnesota), Northern States Power Company (Wisconsin), and Lake Superior District Power Company—October 19, 1983

11. Michigan Power Company—October 20, 1983

12. Minnesota Public Utilities Commission and Minnesota Department of Public Service—October 20, 1983

13. Wisconsin Gas Company—October 20, 1983

14. Iowa Power and Light Company—October 20, 1983

15. Minnesota Municipal Utilities Association and Northern Municipal Distributors Groups—October 20, 1983

16. El Paso Natural Gas Company—October 20, 1983

(C) Protests to deny Northern's petition—Date of Filing

1. R.W. Lange—October 20, 1983

2. Southland Royalty Company—October 24, 1983

3. Resource Tax Group—October 24, 1983

4. Tom F. Marsh, Inc.—October 24, 1983

5. Robert E. Campbell—October 27, 1983

6. Armstrong & Jackman—October 31, 1983

7. Oil Producers, Inc. of Kansas—November 3, 1983

(D) KN Energy, Inc., took no position in its petition to intervene filed on October 20, 1983

APPENDIX I

RELEVANT FEDERAL PUBLIC LAW

Public Law 101-60
101st Congress

AN ACT

To amend the Natural Gas Policy Act of 1978 to eliminate wellhead price and nonprice controls on the first sale of natural gas, and to make technical and conforming amendments to such Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Natural Gas Wellhead Decontrol Act of 1989".

SEC. 2. DEREGULATION OF FIRST SALES OF NATURAL GAS.

(a) INTERIM ELIMINATION OF CERTAIN MAXIMUM LAWFUL PRICES.—Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by adding at the end the following new subsection:

"(f) ADDITIONAL DECONTROL.—The provisions of subtitle A respecting the maximum lawful price for a first sale of natural gas shall cease to apply to natural gas described in paragraphs (1), (2), (3), and (4), as follows:

"(1) EXPIRED, TERMINATED, OR POST-ENACTMENT CONTRACTS.—In the case of natural gas to which no first sale contract applies on the date of enactment

of the Natural Gas Wellhead Decontrol Act of 1989, subtitle A shall not apply to any first sale of such natural gas delivered on or after the first day after such date of enactment.

"(2) EXPIRING OR TERMINATING CONTRACTS.—In the case of natural gas to which a first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, but to which such contract ceases to apply after such date of enactment, subtitle A shall not apply to any first sale of such natural gas delivered after such contract ceases to apply.

"(3) CERTAIN RENEGOTIATED CONTRACTS.—In the case of natural gas to which a first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, where the parties have expressly agreed in writing after March 23, 1989, that all or part of the gas sold under such contract shall not be subject to any maximum lawful price under subtitle A after a specified date, subtitle A shall not apply to any first sale of the natural gas subject to such express agreement delivered on or after the date so specified, except that subtitle A shall not cease to apply to any such natural gas pursuant to this paragraph before the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989.

"(4) NEWLY SPUDDED WELLS.—In the case of natural gas produced from a well the surface drilling of which began after the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, subtitle A shall not apply to any first sale of such natural gas delivered on or after May 15, 1991.

For purposes of this subsection, a first sale contract applies to natural gas when the seller has a contractual obligation to deliver such natural gas under such contract.".

(b) PERMANENT ELIMINATION OF WELLHEAD PRICE CONTROLS.—Title I of the Natural Gas Policy Act of 1978 (15 U.S.C. 3311-3333) is repealed, effective on January 1, 1993.

SEC. 3. TECHNICAL AND CONFORMING AMENDMENTS.

(a) AMENDMENTS EFFECTIVE UPON ENACTMENT.—The Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended—

(A) in the item relating to section 315, by striking "Contract duration; filing" and inserting in lieu thereof "Filing"; and

(B) by striking the item relating to section 507.

(2) Section 315 (15 U.S.C. 3375) is amended—

(A) in the section heading, by striking "CONTRACT DURATION;"; and

(B) by striking "(a) CONTRACT DURATION.—" and all that follows through "(b) FILING OF CONTRACTS AND ANCILLARY AGREEMENTS.—".

(3) Section 502(d) (15 U.S.C. 3412(d)) is repealed.

(4) Section 504(b) (15 U.S.C. 3414(b)) is amended—

(A) in paragraph (1), by striking "paragraphs (2) and (3)" and inserting in lieu thereof "paragraph (2)";

(B) by striking paragraph (3); and

(C) in paragraph (4), by striking "paragraph (1), (2), or (3)" and inserting in lieu thereof "paragraph (1) or (2)".

(5) Section 506(d) (15 U.S.C. 3416(d)) is repealed.

(6) Section 507 (15 U.S.C. 3417) is repealed.

(7) Section 601 (15 U.S.C. 3431) is amended—

(A) by amending subsection (a)(1)(E) to read as follows:

"(E) CERTAIN ADDITIONAL NATURAL GAS.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is not subject to a maximum lawful price under subtitle A of title I by reason of section 121(f), effective as of the date such gas ceases to be subject to such maximum lawful price."; and

(B) in subsection (c)(2), by striking "purchase of natural gas" and all that follows through "under section 202)," and inserting in lieu thereof "purchase of natural gas if, under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act,".

(b) AMENDMENTS EFFECTIVE ON JANUARY 1, 1993.—Effective on January 1, 1993, the Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended by striking the items relating to title I and section 503.

(2) Section 312(c) (15 U.S.C. 3372(c)) is amended by striking "any natural gas" and all that follows through "(3)" and inserting in lieu thereof "any natural gas".

(3) Section 313 (15 U.S.C. 3373) is amended by inserting ", as such section was in effect on January 1, 1989" after "section 107(c)" both places it appears, and after "section 105(b)(3)(B)" both places it appears.

(4) Section 501(c) (15 U.S.C. 3411(c)) is repealed.

(5) Section 503 (15 U.S.C. 3413) is repealed.

(6) Section 504(a) (15 U.S.C. 3414(a)) is amended by striking "person" and all that follows through "to otherwise" and inserting in lieu thereof "person to".

(7) Section 601 (15 U.S.C. 3431) is amended—

(A) by amending subsection (a)(1)(A) to read as follows:

> "(A) APPLICATION TO FIRST SALES.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to any natural gas solely by reason of any first sale of such natural gas.";

(B) by striking subparagraphs (B) and (E) of subsection (a)(1);

(C) by redesignating subparagraphs (C) and (D) of subsection (a)(1) as subparagraphs (B) and (C), respectively;

(D) in subsection (a)(1)(C) (as redesignated by subparagraph (C) of this paragraph), by striking "subparagraph (A), (B), or (C)" and inserting in lieu thereof "subparagraph (A) or (B)";

(E) by amending subsection (b)(1)(A) to read as follows:

"(A) FIRST SALES.—Except as otherwise provided in this subsection, for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable."; and

(F) in subsection (b)(1)(D), by striking "if such amount does not exceed the applicable maximum lawful price established under title I of this Act".

(8) Section 602(a) (15 U.S.C. 3432(a)) is amended—

(A) by striking "AUTHORITY TO PRESCRIBE LOWER" and inserting in lieu thereof "AUTHORITY TO PRESCRIBE"; and

(B) by striking "which does not exceed the applicable maximum lawful price, if any, under title I of this Act".

Approved July 26, 1989.

APPENDIX J

RELEVANT FEDERAL STATUTES

15 U.S.C. § 3320 (1988)

Treatment of State severance taxes and certain production-related costs

(a) Allowance for State severance taxes and certain production-related costs

Except as provided in subsection (b) of this section, a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this part if such first sale price exceeds the maximum lawful price to the extent necessary to recover—

(1) State severance taxes attributable to the production of such natural gas and borne by the seller, but only to the extent the amount of such taxes does not exceed the limitation of subsection (b) of this section; and

(2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

(b) Limitation on State severance taxes

The State severance tax allowable under subsection (a)(1) of this section with respect to the production of any natural gas may not include any amount of State severance taxes borne by the seller which results from a provision of State law enacted on or after December 1, 1977, unless such provision of law is equally applicable to natural gas produced in such State and delivered in

interstate commerce and to natural gas produced in such State and not so delivered.

(c) "State severance tax" defined

For purposes of this section, the term "State severance tax" means any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas—

(1) by any State or Indian tribe (as defined in section 3316(b)(2)(B)(ii) of this title); and

(2) by any political subdivision of a State if the authority to impose such tax, fee, or other levy is granted to such political subdivision under State law.

(Pub. L. 95-621, title I, § 110, Nov. 9, 1978, 92 Stat. 3368.)

15 U.S.C. § 3411

General rulemaking authority

(a) In general

Except where expressly provided otherwise, the Commission shall administer this chapter. The Commission, or any other Federal officer or agency in which any function under this chapter is vested or delegated, is authorized to perform any and all acts (including any appropriate enforcement activity), and to prescribe, issue, amend, and rescind such rules and orders as it may find necessary or appropriate to carry out its functions under this chapter.

(b) Authority to define terms

Except where otherwise expressly provided, the Commission is authorized to define, by rule, accounting, technical, and trade terms used in this chapter. Any such definition shall be consistent with the definitions set forth in this chapter.

(Pub. L. 95-621, Title V, § 501, Nov. 9, 1978, 92 Stat. 3396; Pub. L. 101-60, § 3(b)(4), July 26, 1989, 103 Stat. 159)

15 U.S.C. § 3412

Administrative procedure

(a) Administrative Procedure Act

Subject to subsection (b) of this section, the provisions of subchapter II of chapter 5 of Title 5 shall apply to any rule or order issued under this chapter having the applicability and effect of a rule as defined in section 551(4) of Title 5; except that sections 554, 556, and 557 of such Title 5 shall not apply to any order under such section 3361, 3362, or 3363 of this title.

(b) Opportunity for oral presentations

To the maximum extent practicable, an opportunity for oral presentation of data, views, and arguments shall be afforded with respect to any proposed rule or order described in subsection (a) of this section (other than an order under section 3361, 3362, or 3363 of this title). To the maximum extent practicable, such opportunity shall be afforded before the effective date of such rule or order. Such opportunity shall be afforded no later than 30 days after such date in the case of a waiver of the entire comment period under section 553(d)(3) of Title 5, and no later than 45 days after such date in all other cases. A transcript shall be made of any such oral presentation.

(c) Adjustments

The Commission or any other Federal officer or agency authorized to issue rules or orders described in subsection (a) of this section (other than an order under section

3361, 3362, or 3363 of this title) shall, by rule, provide for the making of such adjustments, consistent with the other purposes of this chapter, as may be necessary to prevent special hardship, inequity, or an unfair distribution of burdens. Such rule shall establish procedures which are available to any person for the purpose of seeking an interpretation, modification, or rescission of, exception to, or exemption from, such applicable rules or orders. If any person is aggrieved or adversely affected by the denial of a request for adjustment under the preceding sentence, such person may request a review of such denial by the officer or agency and may obtain judicial review in accordance with section 3416 of this title when such denial becomes final. The officer or agency shall, by rule, establish procedures, including an opportunity for oral presentation of data, views, and arguments, for considering requests for adjustment under this subsection.

(Pub. L. 95-621, Title V, § 502, Nov. 9, 1978, 92 Stat. 3397; Pub. L. 101-60, § 3(a)(3), July 26, 1989, 103 Stat. 158.)

APPENDIX K

OTHER PARTIES

ANR Pipeline Company
Atlantic Richfield Company
Cabot Oil & Gas Corporation
Chevron U.S.A., Inc.
Cheyenne Light, Fuel and Power Company
Colorado Interstate Gas Company
Colorado Springs Utilities
Conoco Inc.
Consumers Energy Company
Dorchester Hugoton, Ltd.
El Paso Natural Gas Company
Great Plains Natural Gas
Independent Petroleum Association of America
Indicated Producers
Interstate Power Company
Kansas Corporation Commission
Kansas Gas Service Company
Kansas Natural Gas, Inc.
Kansas Small Producers
Kerr McGee Corporation
KN Energy, Inc.
KN INterstate Gas Transmission Co.
Madison Gas and Electric Company
Mesa Operating Corp.
Metropolitan Utilities District of Omaha
MidAmerican Energy Company
Michigan Gas Storage Company
Minnesota Public Utilities Commission
Missouri Gas Energy
Missouri Public Service Commission
Mobil Oil Corporation
Northern Distributor Group
Northern Natural Gas Company

Northern States Power Company (Minnesota)
Northern States Power Company (Wisconsin)
Northwestern Public Service Company
Panhandle Eastern Pipe-Line Company
Pioneer Natural Resources USA, Inc.
Plains Petroleum Company
Plains Petroleum Operating Company
Public Service Company of Colorado
Semco Energy Gas Company
State of Kansas
Texaco Natural Gas Inc.
Undersigned Parties
Utilicorp United Inc.
Vastar Gas Marketing, Inc.
Vastar Resources, Inc.
Western Resources, Inc.
Williams Gas Pipelines Central, Inc.
Williams Natural Gas Company
Wisconsin Gas Company
Wisconsin Power & Light Company

APPENDIX L

CORPORATE DISCLOSURE STATEMENTS

Pursuant to Rule 29.6, petitioners state as follows:

Anadarko does not have parent companies, or subsidiaries (except wholly-owned subsidiaries), or affiliates that have issued common stock or debt securities to the public.

The parent company of Amoco is BP Amoco Company which is a wholly owned subsidiary of BP Amoco Corporation, which is in turn wholly owned by BP Amoco p.l.c. The following is a list of parent companies, subsidiaries and affiliates that may have issued shares or securities to the public:

Amoco Canada Petroleum Company Limited
BP American Inc.
BP Amoco Corporation
BP Amoco Company
BP Capital p.l.c.
BP Developments Australia Pty. Ltd.
BP Exploration & Oil Inc.
BP France
BP Oil Espana SA
BP Oman SAOG
BP Overzee BV
BP Pipelines (Alaska) Inc.
The Standard Oil Company

Mobil Oil Corporation is owned by ExxonMobil Corporation, a publicly held company.

OXY is a wholly-owned subsidiary of Occidental Petroleum Corporation ("Occidental"), also a Delaware corporation, whose debt and equity securities are publicly traded. Occidental also owns a minority interest in Canadian Occidental Petroleum Ltd., a corporation organized under

the laws of Canada. Other affiliates of OXY which have publicly traded debt securities are:

OXY Oil & Gas USA Inc.
Occidental International Finance, N.V.

UPRC is a wholly-owned subsidiary of Resources Holding, Inc., which in turn is a wholly owned subsidiary of Union Pacific Resources Group Inc. The only parent, affiliate or subsidiary of UPRC that has issued shares or securities to the public is Union Pacific Resources Group Inc.